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National Energy Board

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## Reasons for Decision

**Interprovincial Pipe Line Inc.**

**RH-2-91**

**June 1992**

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## National Energy Board

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### Reasons for Decision

### Interprovincial Pipe Line Inc.

Application dated 27 June 1991  
for new tolls effective 1 January 1992

RH-2-91

June 1992





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## Recital and Appearances

**IN THE MATTER OF** the *National Energy Board Act* and the regulations made thereunder; and

**IN THE MATTER OF** an application by Interprovincial Pipe Line Inc. for certain orders respecting tolls and tariffs pursuant to Part IV of the *National Energy Board Act*, filed with the Board under File No. 4200-J001-5.

**HEARD** at Calgary 2, 3, 4, 5, 6, 9, 10 and 11 December 1991; at Toronto 14, 15, 16, 17, 20, 21, 22, 23, 24, 27, 28 and 29 January 1992 and at Calgary 10, 11, 12, 13, 19, 20, and 21 February 1992. Written reply argument by the Applicant was received on 24 February 1992.

### BEFORE:

A.B. Gilmour	Presiding Member
R. Illing	Member
K.W. Vollman	Member

### APPEARANCES:

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E.S. Decter	Shell Canada Limited
D. Todesco A.M. Bigué	SOLIGAZ
L.E. Smith	Suncor Inc.
P.R. Jeffery	TransCanada PipeLines Limited
D.G. Hart, Q.C. D.G. Davies	Union Gas Limited
W.M. Moreland	Alberta Petroleum Marketing Commission
V.J. Black	Ministry of Energy for Ontario
J. Robitaille	Le procureur général du Québec
M.A. Fowke	National Energy Board



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## Abbreviations

the Act	the <i>National Energy Board Act</i>
AEDC	Allowance for Equity Funds Used During Construction
AIDC	Allowance for Interest Used During Construction
AFE	Authority for Expenditure
AFUDC	Allowance for Funds Used During Construction
Airlines	Air Canada and Canadian Airlines International Ltd.
AO	Amending Order
APMC	Alberta Petroleum Marketing Commission
Applicant, Company, IPL	Interprovincial Pipe Line Inc.
Board, NEB	National Energy Board
CanStates	CanStates Energy
CICA	Canadian Institute of Chartered Accountants
CIP	Continuous Improvement Plan
CPA	Canadian Petroleum Association
CWIP	Construction Work In Progress
DCF	Discounted Cash Flow
ERCB	Energy Resources Conservation Board
Gulf	Gulf Canada Resources Limited
Home Oil	Home Oil Company Limited
IPAC	Independent Petroleum Association of Canada
IPL(NW)	Interprovincial Pipe Line (NW) Ltd.
Lakehead	Lakehead Pipe Line Company, Inc.



m <sup>3</sup>	Cubic Metre
m <sup>3</sup> /day	Cubic Metre per Day
NGL	Natural Gas Liquids
NPIS	Net Plant in Service
Ontario	The Ministry of Energy for Ontario
Prospective Shippers	Imperial Oil Limited, Petro-Canada, Shell Oil Limited, and Novacor Chemicals (Canada) Limited
Quebec	Le procureur général du Québec
ROE	Return on Equity
SaskOil	Saskatchewan Oil and Gas Corporation
SOLIGAZ	SOQUIP; Pétromont Inc.; Noverco Inc.; and SNC Inc.
Suncor	Suncor Inc.
TCPL	TransCanada PipeLines Limited
Test Year	1 January to 31 December 1992
TOI	Interim Toll Order
TransAlta	TransAlta Utilities Corp.
TMPL	Trans Mountain Pipe Line Company Ltd.
Westcoast	Westcoast Energy Inc.

## Definitions

13-point average	An average determined by aggregating the balance at the opening of a year and the balances at the end of each month of the year, and dividing by thirteen. Over the years, the Board and others have referred to an average determined in this fashion as a 13-month average.
Beta factor	The measure of the systematic risk of a security. The tendency of a security's returns to respond to swings in the broad market.
Deficiency Agreement	An agreement dated 8 April 1975, as amended, between the Government of Canada and the Company whereby the former has agreed to pay Interprovincial the amount of any shortfall experienced if the annual operating revenues of the Montreal Extension are insufficient to meet its fixed and variable costs of operation.
Flotation allowance	The flotation allowance is intended to cover the underwriting and issuance costs associated with new issues of common equity and minimize the extent to which dilution of the existing shareholders' equity would occur if the the new issue were made at a time when the market price is depressed sufficiently to result in the net proceeds per share being less than the book value per share.
Flow-through income taxes	A method of estimating income taxes payable for a period. This estimate is based on actual taxable income as opposed to an income tax provision based on income for financial reporting purposes.
Integrated System tolls	Tolls that would be paid by all shippers on the Interprovincial pipeline system, and would be derived from the revenue requirement of the entire integrated system.
Montreal Extension	That part of Interprovincial's pipeline system in Canada extending from Sarnia to Montreal that was constructed pursuant to Certificate of Public Convenience and Necessity OC-30, and any additions thereto authorized by the Board.

Normalized income taxes	An estimate of income taxes based on accounting income. The estimate may be greater or smaller than the income taxes payable because of differences in the timing of recognition of certain items of revenues and expenses for accounting as opposed to tax purposes.
Older System	Interprovincial's Canadian pipeline system other than the Montreal Extension
RH-2-76	IPL's first toll design hearing outlining a toll design methodology for the Montreal Extension.
RH-4-86	The Board's proceedings and subsequent Reasons for Decision, in June 1987 in the matter of the Application under Part IV of the <i>National Energy Board Act</i> (Tolls Application) by Interprovincial Pipe Line Limited.
RHW-1-89	The Board's proceedings and subsequent Reasons for Decision, in November 1989, in the matter of a study filed by Interprovincial Pipe Line Company, a division of Interhome Energy Inc. entitled "A Toll Design Study and Recommendation in Response to NEB Reasons for Decision RH-4-86"
GHW-5-90 & RH-3-90	The Board's proceedings and subsequent Reasons for Decision, in February 1991 in the matter of the Application under Part III and Part IV of the <i>National Energy Board Act</i> (Facilities and Tolls Application) by Interprovincial Pipe Line Company, a division of Interhome Energy Inc..
T0-7-90	The Board's review and subsequent Reasons for Decision, in December 1990, of the toll adjustments procedures followed by IPL, TMPL and Trans-Northern Pipelines Inc.
Stand-alone tolls	Tolls that would be paid by only those shippers utilizing the specific facility or asset and would be based on a revenue requirement independent of that calculated for the rest of the system.



### **Note on the Format of the Reasons for Decision**

As a result of revisions by the Applicant to its throughput forecast, capital additions and operating expenses estimates, certain components of the revenue requirement are not contained in these Reasons for Decision. They are marked by a "♣" symbol and must be calculated by the Applicant. Accordingly, IPL must file revised rate base, operating expense and revenue requirement data for the Older System and the Montreal Extension and new tolls in accordance with Order TO-1-92 and these Reasons.

Upon receipt of these figures, the Board will confirm that they were determined in accordance with the Board's directions and will then issue a final order approving the new tolls. In the interest of completeness, the Board will subsequently issue an Addendum to the present Reasons containing all approved figures. The Addendum will include the following tables.

- 2-1 Revenue Requirement
- 2-2 Cost of Service Summary
- 3-1 Summary of Rate Base - Older System
- 3-2 Summary of Rate Base - Montreal Extension
- 3-3 Determination of Working Capital - Older System
- 3-4 Determination of Working Capital - Montreal Extension
- 6-2 Approved Deemed Average Capital Structure and Rates of Return for the Test Year - Older System
- 6-4 Approved Average Capital Structure and Rates of Return for the Test Year - Montreal Extension
- 7-1 Provision for Income Taxes and Deferred Taxes
- 9-1 Operating Expenses

IPL is directed to provide a reconciliation for each of the tables listed above showing the nature of the adjustment and the line item affected, the source of the adjustment (i.e. amendments by IPL to its Application during the course of the review or adjustments pursuant to Board decisions) and supporting schedules showing any necessary calculations needed to verify a figure that is not self-explanatory.

## **Overview**

*(Note: This overview is provided solely for the convenience of the reader and does not constitute part of this Decision or the Reasons, to which readers are referred for the detailed text and tables.)*

### ***The Application***

On 27 June 1991, Interprovincial Pipe Line Inc. applied to the National Energy Board for new tolls to be effective 1 January, 1992. The Application dealt with issues of rate base, cost of service, rate of return and toll design and tariff matters.

### ***The Hearing***

The hearing lasted a total of 27 days and was conducted in Calgary and Toronto. The first phase opened in Calgary on 2 December 1991 and continued until 11 December 1991. The second phase commenced in Toronto on 14 January 1992 and continued until 29 January 1992. The third phase of the hearing was held in Calgary from 10 February 1992 to 13 February 1992. Final argument was heard orally in Calgary from 19 February 1992 to 21 February 1992 with IPL's reply argument filed in writing on 24 February 1992.

### ***Revenue Requirement for 1992***

The Board has not included final approved test-year revenue requirements or new tolls in these Reasons for Decision. After receipt of figures to be provided by the Applicant, the Board will verify them and issue a final order to approve the new tolls.

The Board's preliminary estimate based on the numbers available on the record is that its decisions will result in an approved total revenue requirement that will reflect little change in the level of the revenue requirement from the previous year. The final actual figures will not be available until after IPL has filed the required revised schedules.

### ***Rate Base***

With respect to the issue of earning a return on capital projects which have been approved and subsequently deferred, the Board ruled that a Net Plant In Service adjustment mechanism be established which would capture the average difference between the estimated net plant and the actual net plant over the previous five years.

### ***Rate of Inflation***

The rate of inflation approved by the Board for 1992 is 2.5 percent.

### ***Capital Structure and Rate of Return***

The Board approved a deemed common equity ratio of 45.0 percent exclusive of deferred taxes.

The Board has approved a rate of return on common equity of 12.50 percent.

### ***Income Taxes***

The Board ruled that incomes taxes should be calculated on a flow-through rather than on the previously-approved normalized basis.

### ***Throughput***

During the proceedings, the Applicant revised its 1992 test-year throughput estimate from 221 800 m<sup>3</sup>/day to 220 800 m<sup>3</sup>/day. The Board approved IPL's revised throughput forecast for the 1992 test year.

### ***Operating Costs***

The Board agreed with IPL's intention to initiate a Continuous Improvement Program during the 1992 test year with stated objectives and meaningful performance indicators. In addition, IPL is required to file progress reports on the CIP and serve the reports on any other party who requests them. The Board requires these reports to be filed at the same time as IPL files its quarterly surveillance reports.

The Board disallowed the recovery of all external preliminary investigation costs related to the SOLIGAZ project and the Edmonton NGL project. In addition, the Board ruled that in the future, all preliminary investigation costs, both internal and external, be tracked and details be provided when applying for recovery of these costs.

With respect to IPL's High Resolution Inspection Program, the Board disallowed IPL's request for \$3.6 million related to internal inspection and \$2.3 million related to corrosion and inspection repairs.

### ***Toll Design***

IPL submitted proposed tolls based on an integrated toll design methodology. In addition IPL requested that the Board consider the appropriate toll design for the possible reversal of the Montreal Extension.

The Board ruled that a stand-alone toll design is appropriate for the 1992 test year for each of the Older System and the Montreal Extension.

The Board determined that the appropriate toll design for a reversed Montreal Extension is a stand-alone toll design. In addition, under the existing conditions of IPL ownership of the Montreal Extension, the Board does not believe that revaluation of the Montreal Extension rate base is appropriate. However, should the Federal Government exercise its option and resell the line the question of rate base revaluation may be reconsidered at a future toll hearing.



## Chapter 1

# Background and Application

---

### 1.1 Background

Interprovincial Pipe Line Inc. ("IPL, the Company, the Applicant") which commenced operations in 1950, is engaged in the business of transporting crude oil and other liquid hydrocarbons through a common carrier pipeline system.

The Company's pipeline system consists of three parallel lines of pipe from Edmonton, Alberta to Superior, Wisconsin and a fourth line from Cromer, Manitoba to Gretna, Manitoba. The system further consists of two lines from Superior to Sarnia, Ontario, one via the Strait of Mackinac and the other via Chicago, Illinois; two lines from Sarnia to Toronto through Westover, Ontario, with laterals from Westover to Nanticoke, Ontario and Buffalo, New York; a line from Sarnia to Montreal, Quebec, referred to as the Montreal Extension; and a pipeline from Norman Wells, Northwest Territories to Zama, Alberta.

Lakehead Pipe Line Company, Inc. ("Lakehead"), until recently a wholly owned subsidiary of IPL, owns and operates the portion of pipeline located in the United States ("U.S.") while another wholly owned subsidiary, Interprovincial Pipe Line (NW) Ltd. ("IPL(NW)") owns and operates the Norman Wells pipeline.

In December 1986, IPL diversified into the upstream oil and gas sector with the acquisition of all the shares of Home Oil Company Ltd ("Home Oil").

On 4 May 1988, the shareholders approved a change in the name of the Company to Interhome Energy Inc. from Interprovincial Pipe Line Limited. The new name reflected the operations of the Company's two complementary but distinct business units.

Oil and gas operations were discontinued on 1 May 1991, when a restructuring of Interhome Energy Inc. created two separate companies, Home Oil and IPL.

Two other significant corporate events have taken place over recent months.

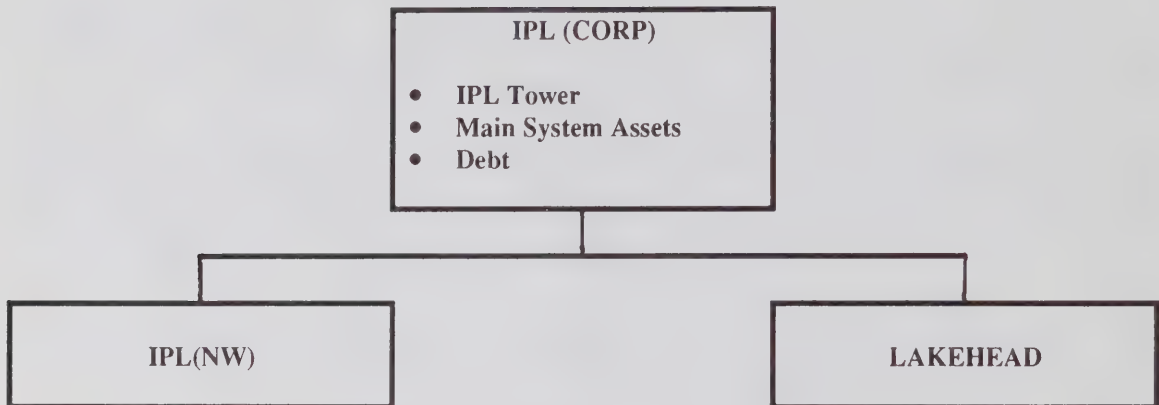
The first event involved a restructuring and refinancing transaction involving the U.S. pipeline business of wholly owned Lakehead. Under the new structure, Lakehead would transfer its U.S. pipeline business to a limited partnership in which 80 percent would be offered to the U.S. public. Lakehead would retain 20 percent interest in the partnership and continue to manage and operate the U.S. pipeline business as general partner.

The second event, announced 22 January 1992, involved a plan for corporate reorganization. The reorganization will separate the Older System and the Montreal Extension from other IPL investments. IPL believes that the reorganization will simplify and facilitate the regulatory process and provide greater

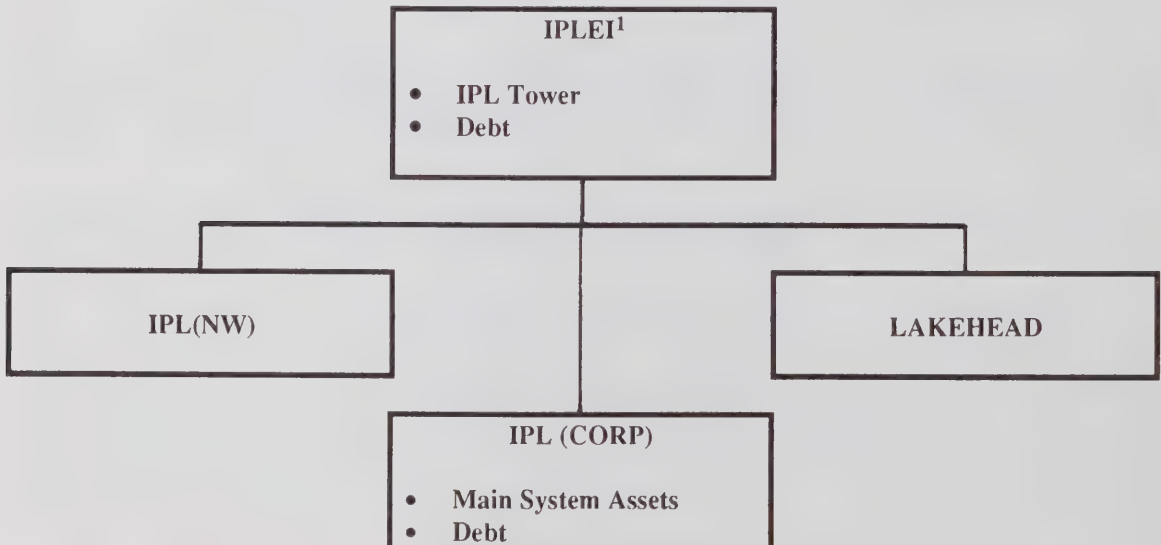
flexibility for the management of existing operations and future opportunities which are either unregulated or regulated separately.

The corporate structure of IPL, before and after reorganization, is shown in the following schematic as excerpted from IPL Exhibit B-48.

#### BEFORE REORGANIZATION



#### AFTER REORGANIZATION



1 Interprovincial Pipe Line Enterprises Inc.

## 1.2 Application

In its June 1987 Reasons for Decision, RH-4-86 ("RH-4-86") the National Energy Board ("the Board, NEB") ruled that the issue of the appropriate toll design for the Montreal Extension would be addressed at IPL's next Class 3 Toll hearing.

IPL was originally scheduled to file a Class 3 Toll application for the 1991 test year. However, at IPL's request, this filing was postponed for one year.

In response to a request from the Minister of Energy, Mines and Resources dated January 1991, the Board conducted an inquiry into various aspects of a planned cessation of operation of the Montreal Extension and issued a report entitled "The Sarnia-Montreal Pipeline - A Review and Report by the National Energy Board". In that report, the Board noted that toll design would be an issue in the next Class 3 Toll proceeding.

On 27 June 1991, IPL filed an Application pursuant to Part IV of the *National Energy Board Act* ("the Act") for new tolls for the 1992 test year. As part of its application, the Applicant requested that the Board consider the appropriate toll design related to the possible reversal of the Montreal Extension.

On 9 September 1991, the Board issued Hearing Order RH-2-91 setting the application down for public hearing.

On 10 October 1991, the Board issued Order AO-1-RH-2-91 which indicated that the Board had decided to include the issue related to the reversal of the Montreal Extension and the appropriate toll design methodology associated with such a reversal in the upcoming hearing. The Board also indicated it would examine the issue of the appropriateness of requiring the Applicant to file an updated depreciation study.

Also in this Order, the Board indicated that the hearing would be conducted in three phases. Phase 1, to begin on 2 December 1991 in Calgary and adjourn not later than 20 December 1991, would examine all issues with the exception of toll design. Phase 2, to commence on 14 January 1992 and adjourn not later than 24 January 1992, would cover all matters relating to toll design. Phase 3, to reconvene in Calgary on 10 February 1992, would deal with all issues not examined to date in addition to final argument.

On 5 November 1991, the Board issued Order AO-2-RH-2-91 which added the issue of whether the Applicant's method of accounting for income taxes should continue to be made under the normalized method.

On 13 November 1991, the Board sent a letter to the Applicant which clarified the order in which evidence was to be presented.

On 13 December 1991, the Board issued Order TOI-2-91 which approved an interim toll increase of 9 percent for IPL, effective 1 January 1992, pending the completion of the Board's review of IPL's application. This interim order will remain in effect until the day before the Board's final order on IPL's application comes into effect.



## Chapter 2

# Revenue Requirement

The net revenue requirement that IPL is authorized to collect by means of tolls will consist of the cost of service plus return on rate base less adjustments for certain allocations to Lakehead and IPL(NW), and revenue to be received from operations other than pipeline transportation service. IPL is required to provide the Board with a summary of its net revenue requirement and cost of service using the format set out in Tables 2-1 and 2-2 respectively.

**Table 2-1**  
**Revenue Requirement**  
(\$000)

	Application	Adjustments	NEB Approved
<b>Older System</b>			
Cost Of Service including Income			
Taxes	252,412	✚	
Cost of Capital	<u>75,018</u>	✚	
Gross Revenue Requirement	327,430	✚	
Less: Other Revenue	139	✚	
Cost Allocation Adjustment	<u>1,363</u>	✚	
Net Revenue Requirement	<u>325,928</u>	✚	
<b>Montreal Extension</b>			
Cost Of Service including Income			
Taxes	16,973	✚	
Cost of Capital	<u>6,880</u>	✚	
Gross Revenue Requirement	23,853	✚	
Less: Other Revenue	<u>0</u>	✚	
Net Revenue Requirement	<u>23,853</u>	✚	
<b>Total System Net Revenue Requirement</b>	<b>349,781</b>	✚	

✚ These figures are to be supplied by IPL and shall include all amounts submitted by IPL as updates or changes to its original application and changes made pursuant to Board direction elsewhere in these Reasons for Decision. For further details, see the Note on the Format of the Reasons for Decision, page (x).

**Table 2-2**  
**Cost of Service Summary**  
(\$000)

	Application	Adjustments	NEB Approved
<b>Older System</b>			
Total Operating Expenses	199,485	✚	
Provision for Depreciation and Amortization	38,604	✚	
Other Income Deductions	1,384	✚	
Overhead and Direct Labor Capitalized	(9,379)	✚	
Administrative Charges to Lakehead	(10,820)	✚	
Direct and Administrative Charge to IPL(NW)	(4,030)	✚	
Direct and Administrative Charges to Home Oil	(54)	✚	
Other Deductions From Cost of Service	<u>(471)</u>	✚	
Cost of Service Before Income Taxes	214,719	✚	
Provision for Income Taxes	<u>37,693</u>	✚	
<b>Total Cost of Service</b>	<b>252,412</b>	✚	
<b>Montreal Extension</b>			
Total Operating Expenses	9,868	✚	
Provision for Depreciation and Amortization	<u>7,016</u>	✚	
Cost of Service before Income Taxes	16,884	✚	
Provision for Income Taxes	<u>89</u>	✚	
<b>Total Cost of Service</b>	<b>16,973</b>	✚	

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✚ These figures are to be supplied by IPL and shall include all amounts submitted by IPL as updates or changes to its original application and changes made pursuant to Board direction elsewhere in these Reasons for Decision. For further details, see the Note on the Format of the Reasons for Decision, page (x).

## Chapter 3

# Rate Base

### 3.1 Introduction

Based on the Board's decisions outlined in the following sections of Chapter 3, IPL's approved rate base will be somewhat lower than what the Company had indicated in either its application or its updated financial evidence, dated 28 November 1991. In order to provide the Board, as well as interested parties, with information on the financial impact that these decisions will have on its rate base, the Company is required to complete Tables 3-1 and 3-2 which summarize and compare amounts contained in IPL's original application with the final Board-approved amounts. The column headed "Adjustments" will reflect the impact of amendments to the original application by IPL through the course of the proceedings and decisions made by the Board.

**Table 3-1**  
**Summary of Rate Base - Older System**  
(\$000)

	Application	Adjustments	NEB Approved
<b>Assets in Service</b>			
Transportation Plant	1,109,744	*	
Other Plant	2,307	*	
Leasehold Improvements	2,221	*	
Plant Leased to Others	<u>161</u>	*	
	1,114,433	*	
<b>Accumulated Depreciation</b>			
Transportation Plant	394,152	*	
Other Plant	1,650	*	
Leased Plant	<u>1,041</u>	*	
Total Average Accumulated Depreciation	396,843	*	
<b>Net Assets in Service</b>	717,590	*	
Allowance for Working Capital	12,864	*	
NPIS adjustment	n/a	*	
Less: Deferred Income Taxes	<u>n/a</u>	*	
<b>Total Rate Base - Older System</b>	730,454	*	

\* These figures are to be supplied by IPL and shall include all amounts submitted by IPL as updates or changes to its original application and changes made pursuant to Board direction elsewhere in these Reasons for Decision. For further details, see the Note on the Format of the Reasons for Decision, page (x).



**Table 3-2**  
**Summary of Rate Base - Montreal Extension**  
(\$000)

	Application	Adjustments	NEB Approved
<b>Assets in Service</b>			
Average Gross Fixed Assets	241,120	✱	
Average Accumulated Depreciation	<u>191,376</u>	✱	
<b>Net Assets</b>	49,744	✱	
Allowance for Working Capital	583	✱	
NPIS adjustment	n/a	✱	
Less: Deferred Income Taxes	<u>n/a</u>	✱	
<b>Total Rate Base - Montreal Extension</b>	<b>50,327</b>	✱	

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✱ These figures are to be supplied by IPL and shall include all amounts submitted by IPL as updates or changes to its original application and changes made pursuant to Board direction elsewhere in these Reasons for Decision. For further details, see the Note on the Format of the Reasons for Decision, page (x).

## 3.2 Plant in Service

### 3.2.1 Forecast of Plant Additions

The plant portion of rate base is calculated on a 13-point average basis in accordance with the method approved by the Board in the RH-4-86 proceedings. In its application, IPL estimated that total capital additions would be \$92.6 million in 1992. IPL reduced this estimate by \$6.8 million to \$85.8 million in its updated evidence (Exhibit B-11) dated 22 November 1991.

In argument, IPL noted that it had deferred the following three projects: Authorization for Expenditures ("AFE") 9250B01, AFE 9250B04 and AFE 9250B10. The Board notes that in addition to these projects, there are other 1992 projects that the Company has sought exemption pursuant to section 58 of the Act and that have not yet received Board approval.

### Views of the Board

The Board is not prepared to approve, for inclusion in the rate base, any amount for projects which have not yet received section 58 approval.

#### Decision

The Board directs the Company to exclude the following projects from the 1992 test-year rate base:

AFE		Amount (\$000)
Older System	9008E	72.0
	9182B03	173.0
	9192J04	157.0
	9192J09	34.9
	9193J02	171.0
	9193J07	69.6
	9250B01	0.0
	9250B04	416.0
	9250B10	29.3
Montreal Extension	9269A01	480.0
	9269B01	11.2
	9269B02	4.5
	9269E01	459.0
	9269E02	37.0
	9269F01	7.4
	9269F02	2.2
	9269L99	8.2
	9269M99	1.0

### **3.2.2 Deferral of Approved Capital Projects and Related Return**

During cross-examination, several intervenors, notably the Independent Petroleum Association of Canada ("IPAC"), the Alberta Petroleum Marketing Commission ("APMC") and the Canadian Petroleum Association ("CPA"), expressed concern over projects which were deferred by IPL, but which were originally forecast and included in the Company's test-year rate bases, thereby earning a return. In this regard, IPAC noted that project deferrals increased from a level of \$2.3 million in 1986 to an estimated \$25 million for 1991. IPAC stated that the Board must take action to remedy the situation and disallow from the test-year revenue requirement an amount equal to the return earned on all deferred capital projects over the period 1988 to 1991. In addition, IPAC stated that, to be fair, it would be willing to allow IPL to earn a return on expenditures on capital projects that were not included in the NEB-approved test-year projection.

APMC and CPA also argued that IPL should not be permitted to earn a return on deferred capital projects.

Under cross-examination, IPL acknowledged that, in principle, it is not fair to allow a company to earn a return on money that is not spent. IPL also stated that there might well be situations where it earned a return on capital funds that were not spent, but that there would also be situations where it did not earn a return on capital funds that were in fact spent. IPL maintained, therefore, that fairness dictates that both situations be considered equally.

IPL claimed that in situations where the actual rate base was lower than the approved rate base, but the actual rate of return on equity remained lower than or equal to the approved rate of return on equity ("ROE"), then the Company did not earn a return on capital funds that were in fact not spent. In this regard, IPL noted that over the five-year period from 1986 to 1990, the actual average rate of return was almost equal to the average approved rate of return, which indicates that the Company only earned a fair return on the projects that were completed, and did not earn a return on projects that did not proceed.

IPL submitted that attempting to bring forward previous years' returns on deferred projects to the test year would constitute retroactive ratemaking and would also effectively establish a deferral account, which the Company opposes.

### **Views of the Board**

The Board acknowledges the concerns expressed by intervenors on this issue and notes that IPL's forecast of additions to completed plant, on which IPL earns a test-year return, has exceeded the actual additions in each of the last five years with significant upward variances in each of the last two years. The Board is not persuaded by IPL's argument that interested parties should not be concerned when additions are below forecast if, in such circumstances, the Company's rate of return remains at or below the approved rate of return. The Board agrees with IPAC that



this issue should be viewed in isolation. In so doing, the Board notes that, in a situation where IPL's additions are below forecast, but the Company's rate of return is at or below the approved rate of return, the excess return earned by the Company on deferred projects may, in fact, be offsetting inefficiencies or overspending elsewhere in the Company's operations. Consequently, the Board has decided to establish a procedure which will allow shippers to recapture, through tolls, on a prospective basis, any excess return that IPL may earn on deferred capital projects in those years when the Company overestimates plant additions.

At the same time, the Board considers it only fair that in those years when the Company adds more to its completed plant than originally forecast, it should be able to earn a return on the excess amount of plant additions, if the projects that contributed to the excess were prudently incurred.

The Board believes that IPL should establish a Net Plant in Service ("NPIS") adjustment mechanism that will capture in 1992, as well as in future test years, the average difference between the estimated net plant and the actual net plant over the five-year period preceding the test year..

This average difference, when expressed as a percentage, is the adjustment factor which IPL would apply to the test-year estimate of NPIS and the resulting amount would be either added to or deducted from the projected NPIS in determining the test-year rate base. This adjustment mechanism would also capture differences in salvage and retirements.

The Board acknowledges that this mechanism does not recover the depreciation charged when the actual amount of capital additions is less than that included in the test-year forecast. However, the Board notes that this would tend to be offset, to a degree, in those years when actual capital additions exceed the forecast. As well, when actual capital additions are lower than forecast, tollpayers receive the benefit of a reduced income tax allowance from what the income tax allowance would have been had the Company correctly forecast the lower level of additions. This is because the Company, when preparing its forecast, would have calculated the capital cost allowance and the associated income tax provision assuming the higher forecast level of capital additions.

## **Decision**

**The Board directs IPL to establish, commencing in the 1992 test year, a NPIS adjustment mechanism that will capture in 1992, as well as in future test years, the average difference between the estimated net plant and the actual net plant over the five-year period preceding the test year. Notwithstanding the implementation of this NPIS adjustment mechanism, the Board will continue to monitor IPL's estimated plant additions in future toll proceedings.**

### 3.2.3 Switchgear Replacement Program

IPL initiated a long-range switchgear replacement program in its 1991 construction program. The program would see some 55 switchgear cubicles replaced over a ten-year period at a projected total cost of \$120 million.

IPAC voiced its objection to the replacement program stating that, in its view, justification had not been sufficiently demonstrated by IPL and that selective problems in existing switchgear did not warrant a full scale replacement program. In response to an information request by IPAC, the Applicant defended its proposal on the grounds that the age and condition of the switchgear cubicles would lead to an increasing probability of failures in coming years. Throughput losses and reduced employee safety were advanced as the key risks in the event of failures.

During cross-examination, the Applicant reiterated that while safety was a concern, the primary justification for the replacement was age and condition. It was stated that the absence of an overwhelming history of failures does not change the expectation that an increase in significant failures could occur. Given the long lead time of one year required to procure and install such equipment, one mobile unit per division could still leave the system vulnerable. Over time, the increasing expectation of failures would lead to many switchgears being purchased on rush orders as opposed to being planned on a program basis. From the safety perspective, the possibility of changing operating procedures to ensure that employees are not in the cubicle at critical times was also explored during cross-examination. The frequency of starts and stops and the remote operation of the system make such changes difficult.

Justification based on throughput given the forecast excess capacity was also explored. The Applicant stated that based on past experience, month-to-month changes in throughput can lead to capacity limitations even when excess capacity has been forecast. Evidence submitted in response to an undertaking demonstrated that throughout 1991 the system was at capacity most of the time. It was stated that a loss of pumping units for more than a few days could further limit the capacity and reduce throughput. Given the test-year throughput forecasts this situation will likely be no different in 1992.

Cost increases were also questioned, and were explained as resulting from various design improvements.

In final argument, IPAC reiterated its position and set out a four-point proposal reflecting alternatives which had been discussed during cross-examination. Specifically, the proposal called for, (i) selective replacements at key initiating stations, (ii) purchase of a mobile switchgear unit for each district to handle emergency situations, (iii) revised operating procedures to allow for scheduled maintenance when a station is out of service and, (iv) replacement of other switchgears on an as-needed basis. IPAC submitted that approval of the switchgear replacements should be denied, at least until IPL could explain why IPAC's proposal is inappropriate and until filing of a complete cost/benefit analysis. Furthermore,

IPAC called for justification of switchgear expenditures made to date and denial of all such costs in IPL's rate base to the extent that their prudence is not demonstrated. In reply argument, the Applicant stated that a cost/benefit analysis had been included in the project rationale filed in response to IPAC's information request. IPAC's four-point proposal was addressed point-by-point and the Applicant concluded that such a plan would compromise system capacity, reliability and safety and that the need for initiating this program had been established. The Applicant also stated that appropriate justification for past expenditures had been furnished through the section 58 review process.

## **Views of the Board**

In the context of the Part III process, the Board notes that IPAC received a copy of the Applicant's 1992 facilities construction application, which included the switchgear replacement program, in September 1991. All interested parties are welcome to forward comments or concerns to the Board regarding section 58 applications. No such comments were received from IPAC or any other interested party.

The Board also noted IPAC's concerns regarding IPL making expenditures in the absence of demonstrated consideration of alternatives or cost/benefit analysis.

Although the Board believes that past expenditures relating to the switchgear replacement program have been prudent, it also believes that IPL should continue to set priorities for the replacements and to review thoroughly the program at least annually. The Board is of the view that expenditures should not be made simply because a program has been initiated and that each replacement should be viewed as an individual project subject to the same rigorous scrutiny as any other proposed expenditure.

### **Decision**

**The Board directs IPL to set priorities for the switchgear replacements and to review thoroughly the program at least annually. The Board also requires IPL to apply for Part III approval of the replacement of switchgears on an individual basis.**

## **3.2.4 Computer-related Capital Additions**

During cross-examination of IPL's rate base panel, IPAC spent considerable time questioning the Company on its use of cost/benefit analysis. One area of expenditures that IPAC questioned related to IPL's expenditures on computer-related capital assets, where IPL has spent over \$24 million since 1984.

Under cross-examination, IPL conceded that cost/benefit analysis is not presently included as part of section 58 applications. However, in argument, IPL stated that each project was justified and approved over the years through section 58 facility



applications and in response to toll application information requests. IPL explained that the majority of these expenditures was for systems redevelopment, replacing existing systems and adding functionality. In addition, the Company stated that the older computer system was difficult and costly to maintain, that the vendor would no longer support the hardware, and that IPL staff were unable to keep up with the required maintenance. Therefore, IPL claimed, to do nothing was not an acceptable alternative.

IPL stated that the remaining portion of the total expenditures covered the purchase of desktop computers and word processors to provide more efficiency. These expenditures also included funding for new system development initiatives such as the engineering project management systems. IPL stated that the Company's efforts have resulted in cost avoidance in terms of staff additions and that the major systems redevelopment effort will be completed in 1992.

## **Views of the Board**

The Board notes that while the Company's long-range system redevelopment appears to have been prudently carried out, the perceived scope of the total program was not adequately presented at the outset, thereby making overall review difficult.

### **Decision**

**The Board directs IPL, in future, to clearly present its long-range plan at the time computer-related projects are proposed for approval and to include a cost/benefit analysis with the plan.**

## **3.2.5 Mainline Motor Upgrade Program**

The mainline motor upgrade program was part of IPL's 1990 capital construction program. Originally, the program was to cover the replacement of 184 electro-mechanical protection relays at an estimated cost of \$12,000 each for a program cost of \$2.2 million. The cost estimates were based on four prototype installations. In written evidence, the Applicant explained that following the installation of the first 50 units, significant cost overruns were observed, averaging 2.1 times the estimated cost, or \$25,000 each. The program was revised to retrofit only those relays at sites experiencing problems and to proceed with the remaining replacements in conjunction with other electrical projects. In this fashion, the actual cost of each replacement would drop to \$4,000.

During cross-examination, the Applicant explained that one advantage of proceeding with the program was the fact that the relays to be replaced were obsolete and lacked certain operational advantages built into the new solid-state equipment. It was also recognized that as the relays aged, failures would occur more frequently.

The installation of the four prototypes, however, was not indicative of the problems faced in the field. In response to an information request from the Board, the Applicant elaborated on the prototype problems. Specifically, the prototype installations were done in conjunction with the installation of new electrical equipment rather than as replacements, and the prototypes did not provide communication between the new relays and the pipeline control system. Later, it was found that the communications method proposed was not feasible and had to be re-designed, and it was determined that upgrades had to be limited to sites having programmable logic controllers. Also, direct construction costs rose significantly due to difficulties in scheduling the work.

## **Views of the Board**

The Board noted that problems relating to this program increased as the program proceeded. First, an original cost estimate of \$12,000 as compared to the current cost of \$4,000 when installation is combined with other electrical projects indicates that IPL did not adequately review its options at the planning stage. The switchgear replacement program was officially initiated a year later than the mainline motor upgrade following the Milden switchgear failure. However, given the age and condition arguments, IPL must have been aware of the possibility of future widespread switchgear replacements. The Board believes that the advantages of a simultaneous replacement program should have been noted. Further, the decision to select four new installation sites as being representative of 184 varied replacement sites was highly questionable. At best, the Applicant should have initiated a small-scale, as-needed replacement program to ensure prototype accuracy. In addition, the fact that 50 replacements were completed at 2.1 times the estimated cost is of concern to the Board. Once installation difficulties were evident, the program should have been reconsidered with the already-procured relays being installed during scheduled maintenance or under other more predictable circumstances.

The Board is also concerned with the array of project planning and control deficiencies evident in the mainline motor protection upgrade program. While it is acknowledged that the Company halted the program mid-way, the Board finds the entire approach disturbing. The cost overruns on individual units are alarming, particularly in light of the subsequent realization that a much less expensive alternative existed. Fifty-six units were replaced under the program at a cost of \$25,000 each even though an individual unit costs less than \$4,000.

The Board believes it is clear that improvements are required in terms of an ongoing planning for and review of projects to maintain control of expenditures and that a broader look at project options, alternatives and cost and benefits should be mandatory for projects of this nature and scope. Future projects based on limited prototype trials should be initiated on a smaller scale and enlarged once more accurate cost estimates can be established.

## Decision

**The Board directs IPL to closely scrutinize its current procedures and report to the Board on how it intends to evaluate and track projects in the future, This report should include a description of the mechanisms that IPL intends to put in place so that any projects which have costs that are escalating beyond those originally estimated can be suspended pending a review by the Board.**

### 3.2.6 Section 58 Review and Approval Process

Throughout IPAC's written evidence, references were made to concerns related to facilities expenditures. IPAC began by pointing to the increase in capital expenditures which were unrelated to increased capacity over the past six years and went on to argue that the onus for justification of a proposed project must fall on the Applicant. The Board has, over time, in IPAC's view, become more accepting of requests by applicants, and the onus has fallen upon the intervenors to demonstrate inappropriateness of expenditures.

IPAC stated its belief that the upstream industry must become more involved in the review and approval of IPL's capital expenditures. Approval of capital items without public scrutiny leaves interested parties in the position of demonstrating, often after the facilities are in place, why the capital expenditures should not be added to the rate base. In this regard, IPAC recommended a formal separate review and approval process whereby all capital projects would be technically and economically reviewed. Guidelines were put forward addressing adequate notice and forecasting of planned expenditures, separation of maintenance and replacement expenditures from new capital project expenditures, better justification demonstrating a full investigation of alternatives and, for large projects, a complete cost/benefit analysis. IPAC stated that it must be demonstrated that projects result in overall benefits for system-users.

In response to a Board information request, IPAC elaborated on the particulars of the proposed approval process. A review committee comprised of Board staff, industry associations, shippers and IPL would be formed. Following a review by all interested parties of the projects proposed by IPL, the review committee would meet to discuss the proposed projects. A series of meetings could be conducted if necessary, after which IPL would file an application which the Board would formally review and, if deemed appropriate, approve.

During cross-examination the Applicant explained that it has initiated a consultation process with interested parties, and that, in preparation for the 1992 section 58 application, it met on four separate occasions to enable IPL staff to answer questions about the projects and to provide additional information. IPL stated that the IPAC proposals go beyond input and question the management of the pipeline. IPL added that industry is still in the early stages of developing a procedure and of identifying what information the review process would require. A



sense of frustration in industry with the lack of input in the section 58 process has been acknowledged by IPL, and the Applicant agreed that further initiatives could be taken to formalize a review process to ensure more industry input. Further information with respect to net benefit calculations and risk analyses could also be provided to more clearly justify projects.

In final argument IPAC recommended that the Board direct IPL to include, as part of its project justification in future section 58 applications, a complete cost/benefit analysis, as well as a detailed description of alternatives examined.

IPL, in its final argument, acknowledged that industry support for capital programs is important, however, the timeframe required to accommodate IPAC's suggestions was of concern. It was noted that a consolidated joint industry proposal has not yet been put forward, and that any changes in the section 58 facilities application review process must be carefully considered. The process should acknowledge the responsibility of the Applicant to manage its own pipeline. The Applicant went on to reiterate that it is prepared to work with the Board and industry to establish a section 58 review process that will consider cost/benefit criteria and information exchanges.

## **Views of the Board**

It is the Board's view that IPL has demonstrated its willingness to seek more industry input with respect to proposed projects. The Board notes that IPL has met regularly with industry to discuss proposals, and appears to be open to further exchanges. The Board encourages the Applicant and interested parties to continue to work together towards a mutually satisfactory review process. If the involvement of Board staff in the pre-application stage is viewed to be advantageous, such accommodation would be considered upon request. It is the Board's view that this process should be developed as a means of enhancing project justification and streamlining facilities proposals and should not create economic inefficiencies or jeopardize the expeditious processing of safety or environment-related projects.

The Board encourages IPL to continue its current practice of serving copies, rather than summaries, of section 58 applications on interested parties, thereby ensuring a complete understanding of the projects at hand. If interested parties have specific concerns regarding the proposed projects they are invited to make those concerns known to the Board in a timely manner. Those concerns will be considered by the Board in its review of the application.

The Board acknowledges that concise and brief project descriptions are required where applications contain a large number of projects, many of them relatively minor. The rationale for each expenditure, however, should be made apparent regardless of the brevity of the description. Major projects, however, should be justified thoroughly including a discussion of alternatives examined, and a detailed cost/benefit analysis. Such discussions and analyses should clearly identify the long-range scope of the program as perceived where the project applied for is part of a larger program.

## **Decision**

**The Board encourages IPL to continue its practice of serving complete copies of section 58 applications on interested parties, to provide a rationale for each expenditure and, in the case of major projects, to include a discussion of alternatives examined, and a detailed cost/benefit analysis.**

### **3.3 Allowance for Working Capital**

In determining the provision for the number of days that cash working capital was outstanding, IPL noted that it had used the same lead-lag study methodology that had been previously approved by the Board. Based on the results of this study, IPL utilized an 18-day provision for both the Older System and the Montreal Extension versus the 19-day provision for the Older System and the 17-day provision for the Montreal Extension previously approved in RH-4-86.

None of the intervenors took issue with the changes noted above.

## **Decision**

**The Board is satisfied with the determination of IPL's Allowance for Working Capital for the 1992 test year and accepts the change in the provision for the number of days to 18 days for both the Older System and the Montreal Extension. However, the Board directs IPL to recalculate its Allowance for Working Capital for the 1992 test year to reflect the adjustments identified in Tables 3-3 and 3-4. Further, the Board directs that the rate base and revenue requirement be adjusted to reflect this decision.**

**Table 3-3**  
**Determination of Working Capital**  
**Older System**  
(\$000)

	Application	Adjustments	NEB Approved
Cost of Service	252,412	✚	
Cash Exclusions and Non-Cash Items Included in Above:			
Rate Hearing Costs	(450)	✚	
Edmonton NGL Project	(803)	✚	
SOLIGAZ Project	(540)	✚	
Prov. for Depreciation & Amortization	(38,604)	✚	
Depreciation Recoverable on Charges to Lakehead	807	✚	
Depreciation Recoverable on Charges to IPL(NW)	127	✚	
Depreciation Recoverable on Charges to Interhome	13	✚	
Provision for Deferred Income Taxes	(9,152)	✚	
Insurance Expense	(1,250)	✚	
Oil Loss - Physical Loss	(584)	✚	
Oil Loss - Degradation Loss	<u>(1,753)</u>	✚	
<b>Cost of Service Allowance for Working Capital</b>	<b>200,223</b>	✚	
Cash Working Capital 18/366 x 200,223	9,847	✚	
Operating Materials and Supplies	1,391	✚	
Prepaid Insurance	389	✚	
Employee Mortgages	947	✚	
Goods and Services Tax	<u>290</u>	✚	
<b>Allowance for Working Capital</b>	<b>12,864</b>	✚	

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✚ These figures are to be supplied by IPL and shall include all amounts submitted by IPL as updates or changes to its original application and changes made pursuant to Board direction elsewhere in these Reasons for Decision. For further details, see the Note on the Format of the Reasons for Decision, page (x).

**Table 3-4**  
**Determination of Working Capital**  
**Montreal Extension**  
(\$000)

	Application	Adjustments	NEB Approved
Cost of Service	16,973	✚	
Cash Exclusions and Non-cash Items Included in Above:			
Provision for Depreciation and Amortization	(7,016)	✚	
Insurance Expense	(134)	✚	
Oil Loss -Physical Loss	0	✚	
Oil Loss - Degradation Loss	<u>0</u>	✚	
<b>Cost of Service Allowance for Working Capital</b>	<b>9,823</b>	<b>✚</b>	
Cash Working Capital 18/366 x 9,823	483	✚	
Operating Materials and Supplies Inventories	100	✚	
Prepaid Insurance	42	✚	
Goods and Services Tax	<u>(42)</u>	✚	
<b>Allowance for Working Capital</b>	<b>583</b>	<b>✚</b>	

✚ These figures are to be supplied by IPL and shall include all amounts submitted by IPL as updates or changes to its original application and changes made pursuant to Board direction elsewhere in these Reasons for Decision. For further details, see the Note on the Format of the Reasons for Decision, page (x).

### 3.4 Allowance for Funds Used During Construction ("AFUDC")

IPL used an AFUDC rate of 10.38 percent for additions to completed plant in the 1992 test year. This rate was approved by the Board in RH-4-86. IPL explained that once the Board had made a final determination on the cost of capital for the 1992 test year, it would adjust the 1992 additions, if the changes were significant.

#### Decision

The Board directs IPL to recalculate the AFUDC rate using the approved rate of return on rate base for the 1992 test year, pursuant to Chapter 6 of this Decision. Further, the Board directs that the rate base and revenue requirement be adjusted accordingly to reflect this decision.



## Chapter 4

# Depreciation and Amortization

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### 4.1 Forecast for 1992

IPL, in its original application, estimated that total depreciation and amortization expense for the 1992 test year would be \$45,620,000. In its updated financial evidence, dated 28 November 1991, the Company reduced this estimate by \$538,000 to \$45,082,000.

No parties questioned the Company's estimate of depreciation expense, other than the need for a revised depreciation study which is addressed in the following section.

#### **Decision**

**The Board requires that IPL adjust its forecast of depreciation and amortization expense for the 1992 test year to reflect changes that result from directives contained elsewhere in this decision.**

### 4.2 Depreciation Study

Air Canada and Canadian Airlines International Ltd. ("the Airlines") noted in their intervention that a review of depreciation rates should not be overlooked in the present application.

Under cross-examination by IPAC, IPL stated that the last depreciation study was filed in December 1987 and was effective 1 January 1989. IPL also stated that it was currently working on a new study which it expects to file with the Board in late 1992. In argument, IPL stated that based on this timing, the results of the depreciation study would not be reflected in a Class 2 Toll application until the fall of 1993, which would cover tolls for 1994.

IPL submitted that this should satisfy the concerns of the Board.

#### **Decision**

**The Board accepts the depreciation rates used by IPL for the 1992 test year and also accepts IPL's timetable for the filing and implementation of the updated depreciation study.**

## Chapter 5

# Rate of Inflation

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IPL used the Conference Board of Canada's forecast of the 1992 Consumer Price Index as a measure of inflation to forecast those operating expenses which vary with inflation. For those operating expenses which do not vary with inflation such as salaries and wages, operating fuel and power, oil loss, rent, employee benefits, insurance and taxes other than income taxes, a direct forecast for the test year was made.

In the original application, IPL used an inflation rate of 4 percent. During the hearing, IPL updated the estimate to 3.6 percent based on the September 1991 Conference Board of Canada forecast, and subsequently provided a further update to 2.7 percent based on the December 1991 forecast.

IPAC and CPA agreed with IPL's reliance on the Consumer Price Index as a measure of inflation provided that the most recent forecast is used.

IPAC further indicated that forecasts since December 1991 suggest that the inflation rate may be in the 2 percent range for 1992.

## Views of the Board

The Board accepts the use of the Consumer Price Index as a measure of inflation. It finds IPL's estimate of 2.7 percent to be generally reasonable but, noting that inflation rates entering 1992 have been well below that number, has adjusted it downward to 2.5 percent.

The implications of this inflation rate estimate for investors' expected returns and operating cost increases are discussed in Chapters 6 and 9, respectively.

## Decision

**The Board directs IPL to use an inflation factor of 2.5 percent for 1992 when calculating expenses which vary with inflation.**

## Chapter 6

# Cost of Capital

### 6.1 Older System

For the Older System, IPL initially requested an increase in the deemed common equity ratio from 40 percent to 42.5 percent, an increase in the funded debt rate from 10.47 percent to 10.71 percent, and an increase in the return on common equity from 13.25 percent to 14.0 percent.

As a result of changing economic conditions and the corporate reorganization described in Chapter 1, IPL revised the application during the hearing. The revised return on common equity was lowered to 13.5 percent, and the revised cost rate for unfunded debt to 9.35 percent. Further, IPL asked that an actual capital structure be approved for the new pipeline entity. In summary, IPL requested a rate of return on rate base, as amended, of 10.0 percent for the test year ending 31 December 1992. This amended rate of return on rate base figure compares to the existing approved rate of 10.38 percent. This rate of return was based upon a capitalization that equates to the forecast average utility rate base plus Construction Work in Progress ("CWIP") and deferred assets. The applied-for actual capital structure, as revised, the corresponding individual cost rates and the overall requested rate of return are shown in Table 6-1.

**Table 6-1**  
**Applied-for Actual Average Capital Structure**  
**and Rates of Return for the Test Year**  
**Older System**

	<b>Amount</b> (\$000)	<b>Capital</b> <b>Structure</b> (%)	<b>Cost Rate</b> (%)	<b>Cost</b> <b>Component</b> (%)
Debt - Funded	276,645	36.18	10.71	3.88
- Unfunded	<u>31,454</u>	<u>4.11</u>	9.35	0.38
Total Debt Capital	308,099	40.29		
Deferred Income Taxes	131,590	17.21		
Common Equity	<u>324,988</u>	<u>42.50</u>	14.00	5.95
Total Capitalization	764,677	100.00		
Rate of Return on Rate Base				10.00

## **6.2 Capital Structure**

### **6.2.1 Deemed versus Actual Capital Structure**

In its initial application, the Company applied for a deemed capital structure. In its supplementary evidence, this was amended to a request for an actual capital structure for the test year. This requested change was due to the Company proposing to segregate its pipeline operation from its non-regulated business activities. Under cross-examination, the Company admitted that the reorganization would not take place until May or June 1992. Accordingly, the stand-alone capital structure for the new entity would not be in place until that time. IPL suggested that the Board could use a deemed capital structure until then or assume the reorganization took place 1 January 1992.

No intervenor other than CPA took issue on this matter. CPA raised the concern that the proposed reorganization could result in double leverage and increase the risk of the parent company not being able to provide equity capital for IPL if and when needed.

### **Views of the Board**

The Board is of the view that the proposed reorganization is yet to be approved by the Company's Board of Directors; and accordingly it would be inappropriate for the Board to approve a capital structure which has not yet been adopted by the Company's Board of Directors.

#### **Decision**

**The Board has decided to maintain the Company's capital structure on a deemed basis for the 1992 test year.**

### **6.2.2 Inclusion or Exclusion of Deferred Income Taxes**

IPL indicated that it would prefer to maintain the currently-approved capital structure inclusive of deferred income taxes. One of IPL's expert witnesses (Mr. Venn) also preferred a capital structure with deferred income taxes included to maintain consistency, while IPL's other expert witness (Dr. Evans) was indifferent to the inclusion or exclusion of deferred income taxes in the capital structure so long as an equivalent financial return is awarded.

The expert witness for CPA and APMC recommended a capital structure excluding deferred income taxes. It was his view that this capital structure would then clearly reflect only the investor-supplied capital components. In addition, for comparison purposes, IPL's capital structure would then be on the same basis as other pipelines regulated by the Board.

IPAC supported the views expressed by the expert witness for CPA and APMC on the exclusion of deferred income taxes from IPL's Older System capital structure.

### **Views of the Board**

The Board agrees that it is preferable for the capital structure to clearly reflect only the investor-supplied capital components. Such a capital structure would more



readily permit a meaningful comparison of IPL's common equity ratio with those of other pipelines under its jurisdiction. Accordingly, the Board is of the view that deferred income taxes should be excluded from IPL's Older System capital structure.

## **Decision**

**The Board approves a capital structure for IPL which excludes deferred income taxes.**

### **6.2.3 Common Equity Ratio**

In its initial application, IPL applied for a deemed common equity ratio of 42.5 percent, a level 2.5 percent higher than that currently approved for toll making purposes. The principal reason for the increase sought was IPL's view that the business risk of the Older System had increased since RH-4-86. In its supplementary evidence, IPL requested an actual rather than a deemed common equity ratio but did not revise the level of its requested common equity ratio from 42.5 percent. In applying for a common equity ratio of 42.5 percent, IPL continued the practice of including deferred income taxes in the capital structure.

The applied-for common equity ratio was seen by one of IPL's expert witnesses (Mr. Venn) as necessary to ensure the ongoing financial integrity of the Company. This witness indicated that whether or not the financial integrity of IPL would be jeopardized at a lower equity level is a matter of judgment, and the potential financial risks at a lower equity level to the Company's financial integrity is a matter of degree. During cross-examination, the witness agreed that IPL is a quality credit and a quality company and it has been able to cope with a number of external economic factors better than many other Canadian corporations. Both of IPL's expert witnesses agreed that IPL today presents a better investment opportunity than in 1986.

IPL's other expert witness (Dr. Evans) recommended that the Board adopt a common equity ratio range of 40-45 percent range instead of approving a specific common equity ratio level as, in his view, the process of determining an appropriate common equity ratio is not an exact science and it involves the exercise of judgment. However, he argued that, in aggregate, the business risks facing IPL today are somewhat higher than in 1986/87 and the currently approved common equity ratio of 40.0 percent including deferred income taxes in capital structure was at the lower end of his recommended range. He suggested the Board consider awarding a common equity ratio that is more centrally positioned within his range. Dr. Evans indicated that based on the business risks facing IPL, the mid-point of his range, or 42.5 percent would be an appropriate common equity ratio, inclusive of deferred taxes in the capital structure.

CPA and APMC recommended a deemed common equity ratio of 37.5 percent excluding deferred income taxes. In requesting that IPL's deemed common equity be reduced, CPA and APMC relied upon the advice of their expert witness, Dr. Waters. Dr. Waters, while agreeing that gas transmission utilities carry relatively higher business risks than oil transmission utilities, indicated that the present gap to compensate for IPL's higher business risks relative to the gas transmission utilities is too high. The common equity ratio of 37.5 percent excluding deferred income taxes was, in his view, directly comparable and provides

compensation for the relatively higher business risks of IPL relative to those of the gas transmission utilities. In addition, the witness stated that based on his recommended common equity ratio and rate of return on common equity, IPL's interest coverage ratios would still be higher than those of TransCanada PipeLines Limited ("TCPL").

IPAC, as well as Imperial Oil Limited, Petro-Canada, Shell Oil Limited, and Novacor Chemicals (Canada) Limited (the "Prospective Shippers"), and Saskatchewan Oil and Gas Corporation ("SaskOil") supported the 37.5 percent common equity ratio excluding deferred income taxes from capital structure as recommended by the expert witness for CPA and APMC.

Both expert witnesses for IPL identified certain business risks facing IPL such as supply risk, competitive risk, regulatory risk, environmental risks and throughput-related risks. When asked to quantify the impact of these individual risks on IPL's operation, these witnesses took the view that, in aggregate, the business risks facing the Older System today are somewhat higher than those in 1986. When the CPA/APMC expert witness was asked to evaluate the impact and severity of the business risks identified by the IPL's witnesses on IPL's operations, it was his opinion that the impact of these risks was not meaningfully different today from what it was in 1986.

IPL's expert witnesses took the position that the business risks of the Older System continue to be greater than those of major gas pipelines and this has not changed in the last five years. The CPA/APMC expert witness agreed with this assessment.

There was some discussion as to the possible effect a reduction in the Older System common equity ratio would have on IPL's debt rating. A witness for IPL stated that if the common equity ratio for the Older System is reduced to the level recommended by the witness for CPA/APMC, there would be a real risk of IPL's debt rating being lowered by a partial or possibly a whole category. The lower common equity ratio would result in lower interest coverage ratios and consequently higher borrowing costs for IPL. During cross-examination, the CPA/APMC expert witness indicated that if the Older System's common equity ratio is lowered to his recommended level, IPL's debt rating may be lowered somewhat but this downgrade may not be viewed negatively by creditors and investors since the investment community will take note of IPL's circumstances, interest coverage ratios and return on equity relative to other investment opportunities available in the regulated utility industry.

## **Views of the Board**

Based on the evidence put forward in respect of IPL's operations, it does not appear to the Board that IPL faces a significantly different level of business risk than it did at the time of the its 1986 Class 3 Toll hearing. In reaching its conclusion on the appropriate common equity ratio, the Board was not persuaded that there has been a material change in the business risks facing the Older System today compared with those presented in the 1986 toll hearing.

The Board is of the view that a decision to lower the equity ratio to the level recommended by CPA and APMC, at this time, may result in a lower debt rating for the Company. However, while the Board is not inclined to reduce the common equity ratio to such a low level at this time, the Board is likewise not persuaded that an equity ratio higher than the currently approved level is warranted.



The 1986 approved deemed common equity ratio of 40 percent, with deferred taxes included in the capital structure equated at that time to a deemed common equity ratio of approximately 45 percent, with deferred taxes excluded from the capital structure. The Board is of the view that a common equity ratio of no more than 45 percent, with deferred taxes excluded from the capital structure, is warranted at this time.

#### **Decision**

**The Board approves a common equity ratio of 45.0 percent, with deferred taxes excluded from the capital structure for determining the Older System's overall cost of capital and income tax provision for the 1992 test year.**

### **6.3 Funded Debt**

The long-term debt component of the deemed capitalization represents the average projected test-year balance of debt capital associated with the Older System. The Company applied for an embedded cost rate of 10.71 percent for its long-term debt calculated on a 13-month average basis. During the hearing, IPL indicated that it would not be purchasing the "Series H" Sinking Fund debentures totaling \$5.0 million in 1992 as originally planned, and a \$248,000 capital gain shown on statement 510 of its application would not materialize.

No intervenor took exception to the basis for, or the calculation of the applied-for embedded cost of IPL's long-term debt.

#### **Decision**

**The Board approves the inclusion of long-term debt in the deemed capital structure used for toll-making purposes, and the embedded cost rate of 10.71 percent, adjusted as necessary to reflect IPL's decision not to purchase the "Series H" Sinking Fund debentures during the 1992 test year. The Board directs the Company to recalculate and provide a revised embedded long-term debt cost rate.**

### **6.4 Unfunded Debt**

Unfunded debt represents that portion of IPL's long-term debt which remains to be raised by future debt issuance. This figure is the difference between total capitalization less the funded debt balance and the common equity balance. In its initial application, the Company applied for a cost rate of 10.75 percent for its unfunded debt. Subsequently, this requested rate was revised downward to 9.35 percent. IPL based its request on a projected yield on 10-year Government of Canada bonds of 8.0 percent, to which it added 0.45 percent to move to long-term bonds, plus a 90 basis point spread for corporate above treasury issues. IPL was not certain as to the timing of raising debt capital to finance its unfunded debt position, however, depending upon the financial market conditions, it may float a debt issue near the end of 1992 or early 1993. No intervenor took exception to the revised rate for unfunded debt or to the timing of raising debt capital.



## **Decision**

**The Board approves the applied-for cost rate of 9.35 percent for IPL's unfunded debt.**

### **6.5 Rate of Return on Common Equity**

In its original application, IPL applied for a rate of return on common equity of 14.0 percent. In the Company's supplemental evidence, this rate was revised downward to 13.5 percent. This revised rate of return on common equity of 13.5 percent represents an increase of 25 basis points from the currently-approved level of 13.25 percent. In requesting a rate of return on equity of 13.5 percent the Company relied on the advice of its expert witness (Dr. Evans), who based his recommendation on his consideration of the comparable earnings, discounted cash flow ("DCF") and equity risk premium approaches for estimating the cost of common equity capital.

CPA and APMC also presented evidence in this regard. Their expert witness (Dr. Waters) originally recommended a rate of return on common equity of 12.0 - 12.25 percent. Taking into account the changes in the U.S. and Canadian long-term interest rate spreads and the exchange rate between the U.S. and Canadian dollar since his evidence was filed, the witness focused on the lower end of his range. In determining what he thought to be a fair and reasonable rate of return on common equity for IPL's Older System, Dr. Waters relied on the results obtained from his DCF and equity risk premium analysis.

A brief description of the three tests, comparable earnings, discounted cash flow and equity risk premium method follows.

#### **Comparable Earnings**

This technique attempts to satisfy the criterion that the regulated utility be permitted to earn rates of return on invested capital commensurate with those of non-regulated enterprises of similar risk. This approach can be considered an "opportunity cost" approach in that the fair rate of return is determined on the basis of returns foregone in investments of similar risk.

#### **Discounted Cash Flow**

This technique examines the required rate of return of an investor in a stock of similar risks to the utility. It is based on the premise that an individual invests in common stock with an expectation of returns on that investment from two possible sources: the dividend stream and capital appreciation (i.e. the gain expected when the stock is sold at the end of the holding period). Accordingly, the expected return is made up of two components: a dividend yield component and a growth factor component. This technique further assumes that the current price of a stock reflects the market's expectations for both of these elements. The investors' expected rate of return is the discount factor used to equate these two elements to the present value of the investment.

## Equity Risk Premium

This technique is based on the premise that an investment in common equity carries greater risk than an investment in either debt or preferred stock and, therefore, requires a higher return or premium over that required for bonds or preferred shares. Risk premiums, for a sample of reasonably similar companies to the utility in question, are determined as the difference in investors' expectations for common stock returns relative to those for bonds or preferred shares. The equity risk premium determined for the sample may then be adjusted to reflect the risk level of the utility stock relative to the stocks of companies included in the sample.

The Company's expert witness and the expert witness for CPA/APMC applied some or all of these tests to arrive at their recommended rate of return on common equity for IPL's Older System and the results of various tests are summarized in the following tables.

Dr. Evans (for IPL)				
Test	Investors' Required Rate of Return (%)	Adjustment for Market to Book Ratio (%)	Adjusted Test Results (%)	Fair Rate of Return (%)
Comparable Earnings	13.75-14.25	N/A	13.75-14.25	13.75-14.25
Discounted Cash Flow	13.00-13.25	0.60-1.25	13.60-14.50	13.75-14.25 <sup>1</sup>
Equity Risk Premium	13.0	0.60-1.20	13.60-14.20	13.75-14.00 <sup>1</sup>
Recommended ROE				13.75-14.25
Final Recommended ROE				13.25-13.75 <sup>2</sup>
Notes:				
1.	Dr. Evans focused his fair rate of return for the DCF and Equity Risk Premium tests on the mid-point of his adjusted test results.			
2.	Dr. Evans adjusted his recommended ROE downward by 50 basis points during the hearing to reflect prevailing financial conditions and focused on the mid-point of this range.			
IPL revised its original ROE request from 14.0 percent to 13.5 percent, the mid-point of Dr. Evans' final recommended range.				

**Dr. Waters (for CPA/APMC)**

Test	Investors' Required Rate of Return (%)	Adjustment to Reflect Lower Risk of Pure Utilities (%)	Adjusted Test Results (%)	Fair Rate of Return (%)
Comparable Earnings	N/A	N/A	N/A	N/A
Discounted Cash Flow	11.0	(.60-.80)	10.2-10.40	10.25-10.50 <sup>1</sup>
Equity Risk Premium	11.2-11.8	N/A	11.2-11.8	11.25-11.75 <sup>1</sup>
Recommended ROE				12.00-12.25 <sup>2</sup>

Notes:

1. Rounded
2. Dr. Waters' recommended ROE was 12.00-12.25 percent with emphasis on the lower end of this range. His final recommendation placed reliance on the Equity Risk Premium Test to which he added 50 basis points as a cushion to reflect prevailing financial conditions.

With respect to the comparable earnings test, in his original written evidence, IPL's expert witness, after examining the historical rates of return earned by a sample of high-quality, low-risk unregulated companies, concluded that the prospective rate of return on book equity for such companies was in the range of 13.75 to 14.25 percent. The witness added that, considering the comparative risks of the Older System, it is reasonable to adopt the results of the comparable earnings test as a fair rate of return for the Older System.

In his written evidence, Dr. Evans indicated that economic conditions, especially inflation experienced during the time period selected (1983-1990) for the purposes of the comparable earnings test, were similar to the conditions that exist today and are currently in prospect for the test year. However, in his supplementary evidence, both long-term inflation and long-term Government of Canada bond yield expectations were revised downward by more than one percent. While no revision was made to the results of his comparable earnings test, the witness did reduce the overall rate of return recommendation by 50 basis points, from an originally recommended range of 13.75-14.25 percent to the 13.25-13.75 range.

In his original filed evidence, Dr. Evans concluded, based on his DCF analysis, that the cost of equity capital for IPL was in the range of 13.75 to 14.25 percent. However, the witness stated that the DCF test results with respect to the investors' growth expectations and experienced growth performance were subject to fairly erratic trends and, under such circumstances DCF test results are far less useful and reliable.

With respect to the use of the equity risk premium approach, Dr. Evans originally concluded that the investors' required rate of return for IPL was in the range of 13.75 to 14.0 percent, assuming a long-term Canada bond yield in the range of 9.5 to



10.0 percent for the test year. However, in his supplementary evidence, the forecast long-term Government of Canada bonds yield was revised downward by 125 basis points to a range of 8.0 to 9.0 percent, while the results of the equity risk premium test were adjusted downward by only 50 basis points. The witness reconciled this variance in the adjustment to his results by postulating that the risk premium increases as interest rates fall.

In recommending an appropriate ROE for IPL's Older System, IPL's expert witness gave more weight to the results of the comparable earnings test and equity risk premium method, as the DCF results were not as reliable in his view. Had he given equal weight to the results of all three tests, the final recommendation would not have been meaningfully different as the results of all three tests were within a very close range. In making his final ROE recommendation, the witness focused on the mid-point of his recommended range of 13.25 to 13.75 percent in recognition of the comparable risks between the Older System and the high-quality, low-risk unregulated companies included in his sample.

In arriving at his final recommendation, CPA/APMC's expert witness, Dr. Waters, did not use the comparable earnings approach because of concerns relating to the distorting effect of inflation and the possibility that the sample selection process might result in a bias towards companies which have the ability to consistently earn rates of return in excess of competitive rates.

In employing the DCF test, Dr. Waters concluded that the investors' required rate of return for his low-risk non-utility sample was no higher than 11.0 percent and, as the comparable risks of pure utilities are lower than the non-utility companies included in his sample, a downward adjustment of 60 to 80 basis points was necessary. Therefore, investors' required return on equity for pure utilities was in the range of 10.25 to 10.50 percent (rounded). The witness added that, in view of the currently unsettled conditions prevailing in the financial markets, it would be appropriate to give more weight to the results of the equity risk premium test, which reflects the current market conditions better than the DCF test. For the purposes of the equity risk premium test, the expert witness calculated total market risk premium to be in the range of 3.5 to 4.7 percent and the comparative risks of utility companies to be no higher than one-half of the total market. On this basis he concluded that the equity risk premium for the Older System was in the range of 1.8 to 2.4 percent. In arriving at the investors' required rate of return on equity, this witness utilized a long-term Canada bond rate of 9.4 percent for the test year. This rate is 90 basis points higher than the mid-point of the long-Canada bond rate forecast of 8.0 to 9.0 percent utilized by the Company witness. He determined that the investor's required rate of return was 11.2-11.8 percent. In addition, the CPA/APMC witness added 50 basis points as a cushion.

Giving most weight to the results of the equity risk premium analysis, the CPA/APMC witness concluded that the investors' required rate of return for IPL's Older System was in the range of 12.0 to 12.25 percent. During the hearing, the witness indicated his preference for the lower end of this range.

In final argument, CPA submitted that IPL's request for an increase in its approved rate of return on common equity was not consistent with the prevailing economic environment and actual developments in the capital markets since the Company's last toll hearing ( e.g. current and forecast lower level of inflation and interest rates).

During cross-examination and in argument, IPAC contended that excessive reliance on the subjective results of the three tests widely used by regulatory bodies fails to conduct any check against reality. In argument, IPAC submitted that, in the current economic environment, a rate of return on common equity for the Older system in excess of 11.0 percent would appear to be excessive.

## **Views of the Board**

The determination of a fair rate of return on common equity was a key issue in this proceeding. This finding involves a high degree of subjective judgment in deciding what a typical investor would expect as a fair return for the test year in question. In addition, because of the Company's diversified activities, which include both non-pipeline activities and pipeline activities not subject to the jurisdiction of the Board, an imputed capital structure for pipeline assets is employed for regulatory purposes. Therefore, there is no empirical market data which the Board can evaluate with respect to IPL's regulated utility operations. In reaching its decision, the Board must rely on a variety of methodologies, each purporting to simulate the fair return required by a typical investor in the equity of a pure utility.

The variety of methods employed by various experts and the range of recommendations attest to the complexities of this undertaking. Nevertheless, the Board considers all of the input received on this issue to be helpful in reaching its finding. The Board notes IPAC's views on the weaknesses of the tests; however, in the absence of any specific proposals for alternative approaches, the Board finds it difficult not to take into account the results of these three tests.

In considering the positions of the various parties, the Board notes that there were considerable differences of opinion among the expert witnesses regarding the comparable earnings test. While the Company's witness put considerable weight on the results of this test, the CPA/APMC witness did not use this test. The CPA/APMC witness argued that the existence of higher than current rates of inflation in the early part of the current business cycle will distort the achieved rates of return over this cycle. The Board is of the view that significant changes in rates of inflation can seriously distort the results of the comparable earnings test. In addition, the extensive reliance on the results of partial business cycles is questionable. For these reasons, the Board has placed less reliance on the results of the comparable earnings test in this proceeding.

The Board noted that the dividend component results of the DCF test concluded by the expert witnesses for the Company and for CPA/APMC were very similar, based on the companies included in their respective samples. However, the growth component results were materially different. The Company witness acknowledged that his analysis of the data did not indicate any reliable expected growth pattern; accordingly he considered the DCF results to be unreliable. The DCF test results for pure utilities arrived at by the CPA/APMC witness were in the range of 10.25 to 10.50 percent. The CPA/APMC witness also indicated that, in view of the unsettled conditions currently prevailing in the financial markets, it would be appropriate to give greater weight to the results of the equity risk premium test. In view of the above, the Board agrees to consider the inherent weaknesses of the DCF test results, at this time, in arriving at its final decision.

Under the equity risk premium methodology, the witness for IPL used a range of 8.0 to 9.0 percent for the long-term Canada rate for the test year while the CPA/APMC witness used a rate of 9.4 percent. Based on the overall equity market risk premium



of approximately 6.0 percent, IPL's witness estimated the risk premium for the Older System to be in the range of 3.0 to 3.5 percent with the focus on 3.25 percent. The total equity market risk premium concluded by the CPA/APMC witness was in the range of 3.5 to 4.7 percent and, in the view of this witness, the risks of IPL's utility operation were no higher than one-half the total market. In his view, the equity risk premium for the Older System was in the range of 1.8 to 2.4 percent. The Company witness disagreed with the CPA/APMC witness that the relative risk for IPL's Older System is only one half of the total market risk.

Having reviewed the evidence presented with respect to the total equity market risk premium, the Board is not persuaded that the total equity market premium at the present time is as high as 6.0 percent. In addition, the Board is of the view that the risks faced by IPL's utility operations at the present time are significantly less than the typical industrial company, but lie somewhere above the level implied by the CPA/APMC witness who used a beta factor of 0.5.

The Board agrees that a premium is necessary to raise the "bare-bones" return so that IPL can attract new equity without dilution to existing equity. However, the Board does not believe the adjustment should also reflect the high market-to-book ratios currently being experienced by high-grade industrials in the unregulated sector, given the perceived floor on regulated earnings.

#### **Decision**

**Having weighed all of the evidence, and giving particular consideration to the decline in inflation and interest rate levels since the Company's last toll hearing and the prospect for inflation and interest rates in the test year, the Board finds 12.50 percent to be a fair rate of return on common equity for IPL's Older System.**

### **6.6 Rate of Return on Rate Base - Older System**

#### **Decision**

**Based on its findings in this case, the Board approves for the 1992 test year the capitalization and rate of return on rate base for the Older System shown in Table 6-2.**



**Table 6-2**  
**Approved Deemed Average Capital Structure**  
**and Rates of Return for the Test Year**  
**Older System**

	Amount (\$000)	Capital Structure (%)	Cost Rate (%)	Cost Component (%)
Debt     - Funded	*	*	*	*
- Unfunded	*	*	9.35	*
Total Debt Capital	348,198	55.00		*
Common Equity	<u>284,889</u>	<u>45.00</u>	12.50	5.63
<b>Total Capitalization</b>	<b>633,087</b>	<b>100.00</b>		
<b>Rate of Return on Rate Base</b>				*

\* These figures are to be supplied by IPL and shall include all amounts submitted by IPL as updates or changes to its original application and changes made pursuant to Board direction elsewhere in these Reasons for Decision. For further details, see the Note on the Format of the Reasons for Decision, page (x).

## 6.7 Rate of Return on Rate Base - Montreal Extension

The Company, in its original application, applied for a rate of return on rate base in respect of the Montreal Extension of 13.67 percent for the 1992 test year as compared to the existing approved rate of 10.66 percent. Subsequently, the applied-for cost rate for "Other Debt" was revised downward from 10.75 to 9.35 percent, resulting in a rate of return on rate base of 13.58 percent. The applied-for capital structure, corresponding individual cost rates and requested rate of return on rate base are shown in Table 6-3.

**Table 6-3**  
**Applied-for Average Capital Structure**  
**and Rates of Return for the Test Year**  
**Montreal Extension**

	<b>Amount</b> (\$000)	<b>Capital Structure</b> (%)	<b>Cost Rate</b> (%)	<b>Cost Component</b> (%)
Debt    - Funded	54,905	119.65	10.87	13.01
- Other	<u>2,800</u>	<u>6.10</u>	9.35	0.57
Total Debt Capital	57,705	125.75		13.58
Deferred Income Taxes	<u>(11,817)</u>	<u>(25.75)</u>		
<b>Total Capitalization</b>	<b>45,888</b>	<b>100.00</b>		
<b>Rate of Return on Rate Base</b>				<b>13.58</b>

The component of the capital structure labeled "Debt - Other" relates to funds for future capital additions to the Montreal Extension. These funds are permitted to earn the lesser of the approved rate of return on equity for IPL's Older System or the rate at which IPL could issue debentures when no funds are actually borrowed. This conforms to the provisions of an amendment to the Deficiency Agreement between IPL and the Minister of Energy, Mines and Resources which came into effect 1 January 1985. The Company requested that this debt be costed at a rate of 9.35 percent, the same rate as for its unfunded debt balance. No intervenor took exception to this rate; in fact, the expert witnesses for IPL and the CPA/APMC found the rate of 9.35 percent to be reasonable.

### Decision

The Board approves an embedded cost rate for long-term debt of 10.87 percent. In addition, consistent with its decision in section 6.2.2, the Board approves a capital structure for the Montreal Extension exclusive of deferred income taxes. Also, consistent with its decision in section 6.4, the Board approves a cost rate of 9.35 percent for the Other Debt attributable to the Montreal Extension. The approved capitalization and rate of return on rate base are shown in Table 6-4.

**Table 6-4**  
**Approved Average Capital Structure**  
**and Rates of Return for the Test Year**  
**Montreal Extension**

	<b>Amount</b> (\$000)	<b>Capital Structure</b> (%)	<b>Cost Rate</b> (%)	<b>Cost Component</b> (%)
Debt - Funded	54,905	95.1	10.87	10.34
- Other	<u>2,800</u>	<u>4.9</u>	9.35	0.46
Total Debt Capital	57,705	100.00		
 Total Capitalization	 57,705	 100.00		
 Rate of Return on Rate Base				 10.80

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\* These figures are to be supplied by IPL and shall include all amounts submitted by IPL as updates or changes to its original application and changes made pursuant to Board direction elsewhere in these Reasons for Decision. For further details, see the Note on the Format of the Reasons for Decision, page (x).



## Chapter 7

# Income Taxes

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### 7.1 Normalized versus Flow-through Taxes

The issue of whether IPL should continue to use the normalized method in calculating its income tax provision was examined during the hearing.

IPL's assessment, supported by its expert witness, was that it should be allowed to continue to follow the normalized method.

IPL indicated that the use of the normalized procedures was consistent with the cost basis of public utility regulation and its "user pay" focus. The application of normalized procedures where there are accelerated deductions of costs for tax purposes ensures that income tax costs are matched with the period of service, so that the user of the pipeline in the period when the tax provisions are used up and the cost incurred pays the utility for their value. In IPL's view this is a procedure responsive to intergenerational equity concerns.

IPL further noted that the use of the normalized procedure remains consistent with the standards set by professional accounting bodies in Canada and the United States. IPL did concede in this area that while the Canadian Institute of Chartered Accountants ("CICA") Handbook still includes an exception for regulated utilities on the premise that the accounting for expenses should match the manner in which tolls, and therefore revenues, are approved by the regulator, it is clearly not the preference of the accounting standards-setting body, which would like to see all corporations accounting for tax deferral effects under normalized procedures.

IPL concluded that if consideration is given to the public policy dimensions of the regulations which give rise to the tax deferrals, it is intended that the financial benefits of the tax deferral should accrue to the party investing in and owning the assets, namely, in this instance, IPL.

IPL pointed out that it has always followed the normalized procedures in calculating its income tax provision and that there should be a major change in circumstances to warrant a change in treatment. In this instance IPL asserted that no such circumstances exist regardless of the desire of some users to obtain the benefits of the IPL's tax deferrals for themselves, nor the fact that there might be some delay in reaching aggregate crossover.

IPL also suggested that there is no tax inefficiency inherent in deferred tax accounting because it always takes \$2 of net revenue before income taxes to provide \$1 of taxes and \$1 of after-tax income regardless of the methodology employed.

IPL further noted that because the accumulated deferred tax balances in its capital structure served as a zero-cost source of funds, the utility's cost of service is reduced from what it would otherwise be if rate base had been solely financed by debt and equity capital.

IPL was of the view that a further benefit has accrued to its shippers because of the reduction in financing that accrues to IPL from having used normalized procedures over the year. IPL also pointed to the higher quality of the earnings that resulted from normalized procedures and the associated improved interest coverage.

IPL pointed out that over time it has experienced several aggregate crossovers or times when deferred tax drawdowns existed.

CPA countered IPL's position by contending that in the case of a regulated utility flow-through and normalized tax accounting are equally acceptable, as long as the criteria in the CICA Handbook paragraph 3470.59 and .60 are met.

CPA agreed that the Board must consider whether it is likely that the flow-through method would be continued in future periods and whether there is a possibility that those amounts can be collected from the customers. CPA was of the view that if the Board can satisfy itself on these two criteria, there would be no qualification by the auditors.

CPA noted that TCPL and Westcoast Energy Inc. ("Westcoast") as well as other Canadian utilities are on flow-through taxes .

CPA believed that IPL's witness did not fully appreciate the difference between the regulated and non-regulated utility in that the latter does not have the assurances that its costs will be recovered and that this difference is a significant underpinning for the regulated utility exception in the CICA Handbook.

CPA was of the view that given the regulated nature of a utility, where revenues are set equal to costs, the principle of matching costs and revenues is automatically achieved under both methodologies.

Referring to the level of the deferred taxes now on the books of IPL, CPA pointed out that the dollar amount has more than doubled since 31 December 1986. Deferred income taxes now represents 17.21 percent of the Older System's average capital structure (up from 10.77 percent in 1986). The significant increase in the deferred balance and the absolute dollar figure are of concern to the shippers on IPL.

CPA argued that the shippers are in effect involuntary investors in IPL.

CPA also pointed out that since IPL had not been reviewed in a Class 3 Toll proceeding since 1986, the full effect of any savings from increased funding from deferred taxes was not passed on to shippers. This is attributed to the fact that the capital structure during the five-year period 1987-1991 assumed only 11.13 percent for deferred taxes at a zero-cost of capital which was the approved level in 1987.

The actual deferred tax balance rose steadily in each of the intervening years to its current level of 17.21 percent of the capital structure for the test year.

CPA was also concerned that while IPL's core maintenance program at \$40 million per year would, by projection, create a crossover or deferred tax drawdown in the mid-1990's, there was no supportable basis for concluding that IPL's expenditures would be limited to core maintenance. Even IPL conceded that annual expenditures were likely to be in the \$65-\$95 million range. CPA pointed out that the 1992 expenditures in IPL's current section 58 application are \$95 million. From this CPA concluded that crossover will be at the earliest the turn of the century or later.

As to the timing of crossover, CPA emphasized that it is the future probability of crossover, not the past, that is important. In this context the point was made that the decision in RH-4-86 to remain on normalized taxes was premised on the consensus view that crossover and a drawdown of the deferred tax balances were imminent. Events have shown this impression was incorrect.

CPA also refuted the argument of a crossover point on an asset-by-asset basis as being unrealistic since depreciation and capital cost allowance in the real world are calculated on a pooled-asset basis.

CPA suggested that the method of tax regulation has no impact on the net income of a regulated company since the accumulated deferred tax balance cannot be distributed to anyone other than the government. Further, since IPL has no right to earn a return on deferred taxes, it loses nothing if converted to flow-through taxes.

CPA also advanced the view that IPL loses nothing of value as long as it can expect the Board to continue to allow the inclusion of taxes payable in future periods in rate charges.

As well, CPA suggested that flow-through taxes are often considered as a means of reducing the impact of intergenerational inequities. Under the flow-through method, early shippers pay a higher return and lower taxes, while later shippers pay a lower return, in both real and nominal dollars, and a higher tax component.

CPA questioned IPL's assertion that the switch to flow-through taxes would impair IPL's ability to raise capital and pointed to TCPL as an example where it has not created significant problems.

IPAC stated that, based on the facts presented at the hearing, two things appeared abundantly clear: firstly, the forecasts of capital additions relied upon by the Board in RH-4-86 were extremely inaccurate and secondly, based upon IPL's best forecasts of capital additions for the future, it is clear that crossover will be deferred indefinitely and certainly beyond the year 2000.



IPAC was of the view that far more was being paid by system-users than is required by IPL to meet its current income tax obligations by allowing taxes to be calculated using the normalized method.

IPAC also suggested, regarding IPL's argument of the deferred tax benefit accruing to the owner of the asset, that it is the system-shippers, and not IPL, which pays for these assets.

SaskOil fully endorsed the evidence of CPA regarding the appropriateness of changing to the flow-through method of accounting for income taxes.

APMC subscribed to the position advanced by CPA and supported by IPAC and SaskOil that the IPL Older System be regulated on a flow-through basis and that IPL be allowed to include only current taxes payable in its cost of service.

APMC found it relevant that the question of timing of crossover be considered in the decision of whether the calculation of taxes using the normalized method continues to be appropriate. Based on the evidence, APMC suggested to the Board that this crossover is unlikely to occur in the short-term and this argues against IPL remaining on normalized tax treatment.

APMC rejected IPL's argument that it is being asked to relinquish something of value. It was also APMC's view that, as a regulated utility, IPL makes capital expenditures to earn a return and will not have had any benefit expropriated or confiscated in the event tax deductions flow through to the tollpayers.

## **Views of the Board**

The Board is of the view that it is well within the framework of the accounting policies established in Canada (CICA Handbook, paragraph 3470.59 and .60) and the United States to direct a regulated company to calculate its provision for income taxes utilizing either the normalized or flow-through calculation as the regulator deems appropriate.

In the context of the referenced paragraph of the CICA Handbook, the Board can see no compelling evidence that IPL would be unable to collect the additional taxes required in future years from its shippers. In addition, the Board does not foresee at this time, not allowing IPL to collect its actual income tax expense in future years through its tolls.

It has become apparent that crossover with subsequent drawdowns of deferred tax credits is not likely to occur in the readily foreseeable future. Under these circumstances, the Board believes it is no longer appropriate to continue to use the normalized method of calculating taxes with a consequent higher charge against users being reflected in tolls. A consequent benefit of the move to flow-through is that the toll increase would be held down in a time of depressed market prices for oil. In making these statements, the Board is cognizant of the core additions projected by IPL for the foreseeable future and also the range of discretionary

expenditures which could by themselves push the crossover point past the year 2000.

With respect to the possible impact that the move to flow-through taxes might have on IPL's ability to finance, it is noted that such a move did not appear to have a detrimental impact on TCPL and the Board is not persuaded that sufficient evidence exists to suggest such an impairment will occur in IPL's case. In addition, the after-tax interest coverage ratio position of IPL is unaffected regardless of which method is used. The after-tax ratio adjusts every utility to the same base regardless of the basis for calculating their taxes, thus ensuring a fair comparison among competing utilities for financing.

It was noted that IPL's after-tax interest coverage ratio is as good as or better than the utility companies against whom it would compete, including TCPL.

The Board was likewise not persuaded that the move to flow-through taxes would be perceived as a change in the regulatory climate under which IPL operates and that it would thereby have its security ratings reduced. In this context, the Board notes that no downgrade of TCPL's securities occurred when it was switched from normalized to flow-through taxes.

With respect to the current deferred tax balance, the Board is of the view that no adjustment need be made at this time to the balance that has accrued from the use of the normalized taxes in past periods, given that crossover is not expected to occur for some time

### **Decision**

**The Board has concluded that the allowance for income taxes to be included in IPL's tolls shall be calculated on a flow-through basis.**

**The Board further directs, with respect to the accumulated deferred tax balance currently on IPL's books, that no adjustment is required at this time.**

## **7.2 Income Tax Rate**

IPL employed an overall income tax rate of 43.742 percent in computing its income taxes. This rate was comprised of a federal corporate tax rate of 28.00 percent and a composite provincial rate of 15.742 percent.

### **Decision**

**The Board approves an overall corporate tax rate of 43.742 percent**

### **7.3 1992 Test-Year Income Tax Calculation**

#### **Decision**

As noted in section 7.1, the Board has denied IPL's request to continue to calculate its income tax provision using the normalized method and has directed it to calculate the income tax provision on the flow-through basis.

IPL shall calculate its provision for income taxes on the flow-through basis utilizing Table 7-1, amended as necessary to reflect the Board's decision.



**Table 7-1**  
**Provision for Income Taxes and Deferred Taxes**  
(\$000)

	Application	Adjustments	NEB Approved
<b>Provision for Income Taxes - Older System</b>			
Rate Base	730,454	✚	
Return	75,018	✚	
Less: Return related to Interest	<u>31,556</u>	✚	
Return related to Equity	43,462	✚	
Adjustments for Permanent Timing Differences:			
Meals and Entertainment	183	✚	
Depreciation of Land Rights	277	✚	
Depreciation of Allowance of AEDC	832	✚	
Amortization of Debt Discount and Issue Expense on Long-Term Debt - Series B-F	50	✚	
Other Non-Deductible Items	92	✚	
Taxable Gain on Debt Recquired	216	✚	
Accounting Capital Gain	(288)	✚	
Large Corporations Tax	<u>1,648</u>		
<b>Income Tax Base</b>	<b>46,472</b>	✚	
Provision for Income Taxes =Income Tax Base x .437424/[1-.437424]	36,134	✚	
Large Corporations Tax - Older System	<u>1,559</u>	✚	
<b>Total provision for Income Taxes and Large Corporations Tax - Older System</b>	<b>37,693</b>	✚	
<b>Provision for Large Corporations Tax - Montreal Extension</b>	<b>89</b>	✚	

✚ These figures are to be supplied by IPL and shall include all amounts submitted by IPL as updates or changes to its original application and changes made pursuant to Board direction elsewhere in these Reasons for Decision. For further details, see the Note on the Format of the Reasons for Decision, page (x).

**Table 7-1 (continued)**  
**Provision for Income Taxes and Deferred Taxes**  
(\$000)

	Application	Adjustments	NEB Approved
<b>Current Provision for Deferred Income Taxes</b>			
Estimated Depreciation	51,311	✱	
Depreciation of Land Rights	(277)	✱	
Depreciation of AEDC	<u>(832)</u>	✱	
Total	50,202	✱	
Amortization of rate hearing costs	450	✱	
Amortization of Debt Discount and Issue Expense on Long-Term Debt			
- Series B-F	50	✱	
- Series G	128	✱	
- Series H	173	✱	
Tax amortization of Series I debt discount and issuance expense	(234)	✱	
Capitalized General and Administrative Overhead	(4,468)	✱	
Capital Cost Allowance	(65,412)	✱	
AIDC	<u>(1,811)</u>	✱	
<b>Net Timing Differences</b>	<b>(20,922)</b>	✱	
<b>Current Provision for Deferred Income Taxes @ 43.7424%</b>	<b>(9,152)</b>	✱	

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✱ These figures are to be supplied by IPL and shall include all amounts submitted by IPL as updates or changes to its original application and changes made pursuant to Board direction elsewhere in these Reasons for Decision. For further details, see the Note on the Format of the Reasons for Decision, page (x).

## Chapter 8

# Throughput

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### 8.1 Test-Year Forecast

IPL initially submitted a forecast of its pipeline system deliveries for the 1992 test year of 221 800 cubic metres per day ("m<sup>3</sup>/day"), the limitation being the estimated sustainable pipeline capacity leaving Kerrobert, Saskatchewan. During the hearing, however, IPL submitted a revised forecast of 220 800 m<sup>3</sup>/day, a decline of 0.5 percent from the original forecast, the limitation in this case being the supply available to IPL. This revised forecast indicated that apportionment of deliveries would not be required during 1992.

The revised estimate of the total supply of western Canadian crude oil and equivalent amounted to 275 300 m<sup>3</sup>/day, made up of 134 000 m<sup>3</sup>/day of conventional light crude oil, 45 600 m<sup>3</sup>/day of synthetic crude oil, 9 200 m<sup>3</sup>/day of pentanes plus and 86 200 m<sup>3</sup>/day of heavy/medium crude oil and bitumen. IPL forecast that, given the domestic demand for western Canadian crude oil, 135 700 m<sup>3</sup>/day of light crude oil and equivalent and 25 200 m<sup>3</sup>/day of blended heavy crude oil and bitumen would be delivered to domestic markets, with the remaining production being shipped to export markets. IPL forecast that it would deliver 110 100 m<sup>3</sup>/day of light crude oil and equivalent, 67 500 m<sup>3</sup>/day of blended heavy crude oil and bitumen and 43 200 m<sup>3</sup>/day of other commodities during the 1992 test year.

IPL explained that its revised forecast reflects new information concerning supply, demand and pipeline operating conditions. The revised estimates of crude oil and equivalent supply and demand for the 1992 test year were obtained in an industry survey conducted in the fourth quarter of 1991, whereas the original information had been obtained in a survey conducted in the first quarter of 1991. The revised estimates of sustainable pipeline capacity reflected the successful completion of hydrostatic tests on the 34 inch line of Lakehead and an increase in the allowable operating pressures for this line from the U.S. Department of Transportation.

IPAC was the only intervenor to question IPL on its throughput forecast for the test year. The questions focused on the basis of the supply estimates, the reasons for the revisions and the possible impact of the province of Alberta's recently announced crude oil exploration and development incentive program. IPAC argued that IPL's forecast should be increased to reflect the impact of this program. IPL contended that its forecast should not be increased to reflect this factor in isolation because all factors would need to be considered in any revision of its forecast. The Board notes that none of the parties could quantify the effect of the province of Alberta's crude oil exploration and development incentive program.

### Views of the Board

The Board questioned whether the Energy Resources Conservation Board's ("ERCB") forecast of conventional light crude oil for Alberta was an appropriate basis for IPL's throughput forecast, given that it was prepared prior to 1 March 1991 and that it was significantly more than estimated from trend



analysis. IPL responded that it relied on the ERCB's forecast because it did not have the resources to make its own forecast.

The Board recognizes that, given the many factors which influence the supply and demand of crude oil and other commodities shipped by IPL, there is some uncertainty associated with forecasts of throughput on the Applicant's pipeline system.

#### **Decision**

**The Board accepts the revised throughput forecast of 220 800 m<sup>3</sup>/day for the test year, and the breakdown of deliveries as filed by IPL during the hearing.**

### **8.2 Production Margins**

Production margins are applied to productive capacity estimates to reflect the effects of plant turn-arounds, field operational difficulties and unforeseen down-times. In the review of the 1989 Class 2 Toll application for the 1990 test year, both IPAC and the Airlines questioned the appropriateness of the production margins used by IPL and the Airlines suggested this be reviewed in the next Class 3 Toll application.

The only adjustment to production applied by IPL, in forecasting the 1992 test-year production, was a historically based production margin applied to forecast supply from the two northern Alberta synthetic crude oil mining plants. The production margin applied in this case was reduced from a level of 5 percent, as approved by the Board in its decision for the 1990 test year, to a level of 2.4 percent in the 1992 test year, based on a five-year historical average.

While the question of production margins was made an issue in the current hearing, no parties cross-examined or presented argument on this issue.

#### **Decision**

**The Board accepts the revision of the synthetic crude production margin implemented by IPL.**

## Chapter 9

# Operating Costs

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### 9.1 Operating Expenses

IPL used 1990 as a base year and adjusted its actual expenses in that year for known and anticipated changes in the 1992 test year. Where appropriate, the Company applied an inflation factor to arrive at test-year costs.

Table 9-1 is a summary of operating expenses comparing amounts in the application to Board-approved amounts. The amounts to be included as adjustments are to reflect revisions made by IPL during the course of the proceedings and decisions made by the Board. These decisions are explained in the following sections of this chapter. Where necessary IPL will be required to fill in the appropriate amount and these amounts will be reviewed by the Board before approval.

Intervenors were quite active during the hearing in this area and their views are reflected in the relevant sections of this chapter as well.

**Table 9-1**  
**Operating Expenses**  
(\$000)

	Application	Adjustments	NEB Approved
<b>Older System</b>			
Salaries and Wages	44,647	✱	
Operating Fuel and Power Costs	71,833	✱	
Materials and Supplies	6,156	✱	
Outside Services	23,073	✱	
Other Expenses	14,474	✱	
Amortization of Toll Hearing Costs	450	✱	
Oil Loss - Physical Loss	584	✱	
- Degradation loss	1,753	✱	
Law Expenses	282	✱	
Rent	6,317	✱	
Employee Benefits	6,550	✱	
Insurance	1,250	✱	
Taxes other than Income Taxes	<u>22,116</u>	✱	
Total	199,485	✱	
<b>Montreal Extension</b>			
Salaries and Wages	1,395	✱	
Operating Fuel and Power Costs	0	✱	
Materials and Supplies	218	✱	
Outside Services	490	✱	
Other Expenses	666	✱	
Amortization of Toll Hearing Costs	0	✱	
Oil Loss	0	✱	
Law Expenses	71	✱	
Rent	340	✱	
Employee Benefits	205	✱	
Insurance	134	✱	
Taxes other than Income Taxes	<u>6,349</u>	✱	
Total	9,868	✱	
<b>Total System</b>	<b>209,353</b>	✱	

✱ These figures are to be supplied by IPL and shall include all amounts submitted by IPL as updates or changes to its original application and changes made pursuant to Board direction elsewhere in these Reasons for Decision. For further details, see the Note on the Format of the Reasons for Decision, page (x).



### **9.1.1 Salaries**

The examination of test-year salaries focused upon the number of permanent employees, the annual rate of increase and the need for an independent audit.

#### **9.1.1.1 Number of Employees**

IPL applied for a permanent staff complement of 804 for the 1992 test year. IPL stated that this level of staff was required for the development of facilities, information systems and employee skills, all of which were backlogged during its period of facilities expansion. As well, this level was required to address the rapid increase in products and shipment complexity.

IPAC believed that IPL's staff contingent was in excess of the level necessary to provide service. IPAC argued that it was impossible for intervenors such as itself to speculate on the precise level of this excess and consequently IPAC was not in a position to recommend staff cuts.

### **Views of the Board**

The Board notes that none of the intervenors could give a definitive estimate of the number of permanent staff necessary to operate IPL in the 1992 test year

#### **Decision**

**The Board finds IPL's applied-for permanent staff complement of 804 for the 1992 test year to be reasonable.**

#### **9.1.1.2 Annual Rate of Increase**

IPL originally applied for a year-over-year salary escalation of 5 percent for the 1992 test year. IPL amended this rate to 4 percent and then subsequently to 3 percent. IPL indicated that these amendments were made in response to the economic conditions in the petroleum industry .

IPAC argued that the level of salary increase approved for IPL should not exceed the most recent forecast of the rate of inflation. IPAC contended that anything above an inflation-related increase would be unjustified as there was no evidence of any increase in the productivity of IPL employees.

### **Views of the Board**

Based on the forecast rate of inflation for the 1992 test year, the Board believes that a 2.5 percent year-over-year salary escalation rate is reasonable.

## **Decision**

**The Board directs IPL to calculate the 1992 test-year salary expense based on a year-over-year escalation rate of 2.5 percent.**

### **9.1.1.3 Need for Independent Study**

IPAC requested that an independent study of IPL's operations be conducted by a third party so that the appropriate staff level for IPL could be determined. No other intervenor requested that a study be conducted.

## **Decision**

**Given that IPL is initiating a Continuous Improvement Plan (see section 9.1.3.1), the Board does not believe an independent study of IPL's operations is required at this time.**

### **9.1.2 Capitalized Salaries**

IPL's policies respecting the Board approved levels for salaries and the allocation between capital and expense were at issue during the hearing.

#### **9.1.2.1 Excess Salaries**

IPL maintained that it applies for a salaries amount which is its best estimate at the time of the application. IPL was of the view that the Board approves the estimate but must recognize that variances can and do occur both above and below the approved amount.

IPAC was of the view that the fundamental issue to be understood was that it is totally inappropriate for IPL to recover more salaries in total than is approved by the Board in any given test year. Once the Board has established an amount of salaries that it approves for the test year, this is the amount that IPL is allowed to recover, irrespective of variances to actual amounts.

IPAC was concerned with IPL's view that the Board approved level was little more than a projected budget as long as the ROE remained below the approved trigger limit of 2 percent.

IPAC was of the view that IPL incurring more or less total salaries than approved was a normal variance and no adjustment should be made which would result in additional salaries being capitalized rather than absorbed by the shareholder..

APMC directionally supported IPAC's views on salaries.

## **Views of the Board**

The Board concurs with the intervenors in this case that, when a salary level is approved for a test year by the Board, then that is the level of total salaries which can be expensed and capitalized by IPL for that particular year.

The Board is of the view that salaries are an expense over which IPL has control and can identify when it will exceed the level which the Board approves. In such instances, if IPL wishes to recover such amounts it should file an application with the Board. This would allow the Board and parties to review the prudence and the need for the additional amounts expected to be incurred.

The Board, however, agrees with IPL that any change of this nature should be implemented on a prospective basis.

### **Decision**

**The Board directs that when IPL becomes aware that the total salaries which will actually be incurred will exceed the level approved by the Board, and wishes to recover such amounts, IPL will file with the Board an application for Board consideration.**

#### **9.1.2.2 Capital versus Expense**

Of even more concern to intervenors was the potential for IPL to stray from the proposed and approved split between salaries to be expensed and those classified to be capitalized (i.e. as they related to capital projects).

IPL stated that it puts forward at the time of its application its best estimate of that portion of its total test-year salaries to be capitalized.

IPL indicated that variances can occur between approved forecast and actual results and there can be over-recoveries and under-recoveries as was demonstrated in Exhibit B-22.

The Company totally disagreed with IPAC's request that the net over-recovery of capitalized salaries since 1986 be credited to the 1992 test-year revenue requirement.

IPL submitted that it did not believe that when the Board approves a capitalized salaries forecast it was establishing a cap on the amount of salaries that could be capitalized in the test year.

IPL was further of the opinion that no deferral account is needed for capitalized salaries and that if one were needed it should be established on a prospective basis.



CPA indicated its concern with IPL capitalizing salaries which have not received Board approval.

IPAC strongly asserted that it was totally inappropriate for IPL to both expense and capitalize the same salaries. IPAC wanted it make it clear that it was not challenging the accounting necessity for the decision between whether to capitalize or expense salary amounts. As a bottom line, IPAC suggested that the total salary actually incurred, both capitalized and expensed, should not be allowed to exceed the level approved by the Board.

IPAC considered that a subsequent variance between these allocations, as long as they do not exceed the approved total, is permitted and expected under IPL's method of regulation. IPAC was concerned that IPL has the ability to adjust the line item and the split between the amount capitalized and the amount expensed so that it could effectively recover the same amount twice: once through the test year revenue requirement and the related tolls and a second time through rate base treatment of the additional amount capitalized in future periods.

It was IPAC's view that the 2 percent trigger for IPL does not constitute a zone of unaccountability within which IPL can operate without scrutiny.

APMC directionally supported IPAC's views regarding capitalized salaries.

## **Views of the Board**

The Board agrees with IPL that the Board is not setting a cap when it approves the capitalized portion of the applied-for total salaries but it does expect that the variances will be reasonable and will not be in one direction only. IPL must be able to substantiate that a trend of over-recovery is not developing.

In the circumstances of this case and the period 1986-1991, the Board believes IPL has amply shown that both over-recoveries and under-recoveries have occurred and the net effect in relation to the total approved salaries for the period examined was well within what could be considered a reasonable variance and level.

The Board agrees with IPAC and other intervenors that, because of the possibility of manipulation in this area which could occur and result in double-recovery, IPL will be required to provide comparative schedules to prove there is no abuse.

The Board does not agree with IPAC that any adjustment is warranted under the particular circumstances and in light of the substantiating evidence provided by IPL.

## **Decision**

**The Board directs IPL that in all future toll applications, whether Class 2 or Class 3, to provide a five-year analysis of salaries in a similar format to Exhibit B-22 to allow a review of the over or**

**under-recoveries that have occurred. While the Board is not directing that a deferral account be established for the variances at this time, if it finds the variances are continually in the nature of over-recoveries, one may be established if it is deemed necessary.**

### **9.1.3 Efficiency Considerations**

#### **9.1.3.1 Continuous Improvement Program**

IPL indicated that it intends to initiate a Continuous Improvement Plan ("CIP") in the 1992 test year. IPL stated that the objective of this program is to identify and eliminate non-essential work, as well as to further improve efficiency and the quality of customer service. IPL stated that a significant component of this program is the proposed development of indices which will measure labor efficiency and the costs and benefits of new technologies. IPL also proposes to look at the measurement of costs and benefits in the core program areas that indirectly affect employee productivity.

CPA stated that it would be supportive of the program and that consideration could be given to the process of sharing benefits between IPL and its shippers to provide incentive to improve efficiency. CPA indicated that it wants to receive copies of the progress reports promised by IPL to the Board.

IPAC stated that it was sceptical of the value of the program in the context of a regulated utility. IPAC indicated that it is concerned that meaningful performance measures will not be developed.

APMC supported the adoption of the program, but had concerns about its implementation and applicability to a regulated utility. APMC agreed that progress reports should be filed with the Board.

### **Views of the Board**

Although the Board is in general agreement with IPL's introduction of a CIP in 1992, it appears to the Board that IPL's management could have achieved at least some of the improvements visualized by consistently applying rigorous and progressive management practices in the past. The Board also questions whether sufficient use has been made by IPL of its Internal Audit group in identifying and proposing remedies for some of the deficiencies identified elsewhere in this decision (e.g. in project engineering, project cost/benefit evaluation, and in control over the High Resolution Inspection Program).

While prepared to approve the CIP, the Board is concerned that it be proven to be cost effective. Thus the Board is of the view that the CIP should, as a minimum, recover all consultant and internal costs expended in developing the CIP during 1992. For 1993, the Board believes that overall net cost reductions should be

attainable with no loss or impairment of service. Indeed enhanced service should be the goal for both 1992 and 1993.

### **Decision**

**The Board directs IPL to develop and file with the Board defined objectives and performance indicators for its CIP. These objectives should include cost reduction targets for 1992 and 1993. The Board also directs IPL to file with the Board, and serve with any other party who requests it, progress reports on the implementation of the CIP. These reports are to be filed with the Board at the same time as IPL files its quarterly surveillance reports.**

#### **9.1.3.2 Incentive Regulation**

IPAC expressed concern that appropriate incentives were not in place to encourage IPL management to become more efficient and that there is a lack of explicit performance measures throughout IPL's operations. IPAC further stated that its vision of incentive regulation is one in which the utility is prompted to achieve improved performance, such as lower costs and enhanced quality of service, through a balanced system of financial rewards. IPAC suggested that it might be appropriate for the Board to institute a generic proceeding to examine this issue. CPA stated that objectives, standards and indices should be established and consideration should be given to a process of sharing any efficiency benefits. IPL stated that it believes that the major incentives for improved performance are the opportunity for challenging work, the chance to broaden skills and knowledge and the recognition given for good performance. APMC stated that although it supports the adoption of IPL's program, it is concerned that, without close regulatory scrutiny, there would be a lack of incentive to control costs. IPL indicated that these incentives are provided through regular discussions of individual performance, development opportunities provided through transfers, promotions and training programs and participation in the challenging initiatives envisaged in the CIP.

### **Views of the Board**

The Board notes that some parties feel the current regulatory framework may not always result in the most efficient operation of pipeline companies. The Board is prepared to consider specific proposals aimed at promoting and rewarding efficiency. Until such proposals have been submitted for consideration in a toll proceeding, however, initiatives undertaken in the context of traditional cost of service regulation, such as the CIP discussed in subsection 9.1.3.1, should result in meaningful improvements in the efficiency of IPL's operations.

As indicated in a letter issued on 23 March 1992, the Board has initiated public consultations in respect of incentive rate regulation. The results of these consultations should be available prior to the next Class 3 proceedings regarding IPL tolls.



## **Decision**

**The Board will not implement an incentive regulation mechanism at this time.**

### **9.1.4 TransAlta Utilities Corp. Deferral Account**

As a result of its review of IPL's 1989 Class 2 Toll application, the Board approved a Fuel and Power Deferral Account with respect to a TransAlta Utilities Corp. ("TransAlta") refund situation for IPL's 1990 operating year. This was a result of TransAlta being ordered to refund excess revenues collected from its customers in 1988 and 1989. The final disposition of the deferral account was to be determined in IPL's next Class 3 Toll application.

IPL requested that it be allowed to include the balance within the deferral account in its 1992 revenue requirement. The balance of this account is comprised of two items. First, it includes an amount of \$117,000 to reflect the refund situation discussed above regarding excess revenues collected in 1988 and 1989. Second, IPL has also included an amount of \$515,000 to reflect a 7.15 percent surcharge to be levied by TransAlta in 1991. Neither of these amounts had been reflected in the Class 2 Toll applications for the years in question but they were recorded in a deferral account for disposition in the next Class 3 Toll application. Initially, IPL forecast a net balance in the deferral account of \$398,000 but has indicated that as at 31 December 1991 the actual amount in the deferral account was \$371,000. IPL proposed that this is the amount that should be included in the 1992 forecast of fuel and power costs.

IPL submitted that it has correctly utilized the deferral account to record items related to TransAlta and requested the costs be allowed for 1992. IPL was of the view that there would be no future need for the account.

No parties objected to IPL's request on this matter.

## **Views of the Board**

The Board agrees with IPL's views on its utilization of the deferral account, the net amount included therein and the lack of any further need for the deferral account.

## **Decision**

**The Board approves the amount of \$371,000 for recovery in IPL's revenue requirement. The Board also directs IPL to abolish the deferral account which had been established.**

### **9.1.5 Oil Degradation Loss**

Starting in 1986, IPL changed its operating procedures concerning batch interfaces to deliver more of the mixed interface oil with the lower quality commodity type than with the higher quality commodity type. The resulting loss of expensive crude oils against the gain of less expensive crude oils results in an oil degradation expense. This expense was first approved by the Board as a cost of service item in 1990.

IPL has provided average oil degradation figures over the five-year period from 1986 through 1990. The Airlines questioned the progressive increase of the expense over the period quoted. IPL cited three reasons for the increase. First, an increase in the price differential between light and heavy crude occurred meaning higher expenses even if the degraded volumes remain constant. Second, an increase in heavy crude receipts led to increased potential for degradation. Finally, operating procedures were changed to reduce the potential contamination. However, further cuts in degradation expense in recent years have been difficult to achieve.

IPL is taking measures to minimize the oil degradation expense by reviewing facilities and operations and by implementing programs to enhance cut point accuracy. The figure of 0.03 percent used to forecast the 1992 oil degradation loss is based on a five-year (1986 to 1990) average. The Company explained during the hearing that it applied the five-year average technique to achieve an objective forecast. Any error in the forecast will be rolled into subsequent years and eventually balance off.

#### **Decision**

**The Board considers that the oil degradation loss expense should remain as a component of the cost of service. The Board agrees that the current methodology employing a five-year averaging technique is both objective and fair and the expense as forecast is approved.**

### **9.1.6 Preliminary Investigation Costs**

IPL requested that the Board approve preliminary investigation costs related to two projects that did not proceed. These projects were referred to as the Edmonton Natural Gas Liquids ("NGL") project and the SOLIGAZ project. The Edmonton NGL project consisted of batch accumulation and injection facilities in Edmonton. The SOLIGAZ project involved the feasibility of delivering NGL via the existing pipeline from Edmonton to Sarnia and using a combination of the existing Line 8 and new 10-inch or 12-inch diameter pipe from Sarnia to Montreal.

#### **9.1.6.1 Internal and External Costs**

The costs which IPL indicated it wishes to recover (\$804,000 for the Edmonton NGL project and \$540,000 for the SOLIGAZ project) reflect only the external costs of these projects to IPL. IPL indicated that it identifies its projects as being either jurisdictional or non-jurisdictional and since it considered the two projects in question as jurisdictional, it did not apply the formal internal cost-tracking as would have been the case for a non-jurisdictional project.

In response to questions at the hearing, IPL contacted all of its departments to obtain a "best estimate" of the internal costs. Based on these discussions the internal time spent on the Edmonton NGL project was estimated at \$400,000 and on the SOLIGAZ project at \$290,000.

IPL was of the view that requiring project support agreements covering both internal and external costs is not something which it or its shippers could support before discussions on a preliminary investigation of a project could take place. IPL further stated that these agreements were secured to solely protect the interests of its shareholders and should not influence the Board as to what costs should be allowed or denied.

CPA was of the view that the significance of the internal costs should not be overlooked but that it was still reviewing its position with respect to internal preliminary investigation costs.

IPAC submitted that it was totally inappropriate to allow internal costs for these projects to be inflicted on current system users. IPAC recommended that IPL be required to separately identify all such costs for the test year and future years so that they can be easily identified and deducted from the revenue requirement approved by the Board.

With respect to the IPAC position on tracking internal costs, IPL held that it would be difficult to apply in its day-to-day operations.

IPAC also suggested that the treatment of all preliminary costs must follow the toll design which was approved or would have been approved for the facility whether it proceeds or not. IPAC suggested that if toll design would be or would have been stand-alone, then preliminary investigation costs should not be recovered from other shippers.

CanStates Energy ("CanStates") supported the inclusion of the Edmonton NGL preliminary investigation costs in the test-year revenue requirement.

SaskOil fully supported IPAC's position that the treatment of preliminary investigation costs must follow toll design and that both internal and external costs should be governed by this test.



SOLIGAZ indicated unqualified support for IPL's position for inclusion of both internal and external costs in its 1992 test-year revenue requirement.

APMC opposed the recovery of any of the preliminary investigation costs. It made no distinction between internal or external costs.

Le procureur général du Québec ("Quebec") supported the recovery of all costs related to the Edmonton NGL and SOLIGAZ projects.

## **Views of the Board**

The Board is of the view that all costs, both internal and external, relevant to preliminary investigation projects should be tracked. In this instance it would be extremely onerous to expect IPL now to be able to arrive at the correct internal costs of the two projects which it had not tracked originally. The estimates provided by IPL were its best efforts to ballpark the costs but it would be difficult to determine the fair cost which should be used. Also, in the past such projects have been reviewed without reference to internal costs by either the Board or intervenors. It would seem only fair to all parties that any change in this area should be done on a prospective basis.

The Board is, therefore, of the view that it would not be reasonable to attempt to quantify these costs and exclude them from the test year. However, the Board will require that in future all costs internal and external, related to a preliminary investigation project be tracked by IPL and details provided when requesting inclusion of any or all of the costs related to the project in a test year revenue requirement.

The Board further agrees that any treatment of preliminary investigation costs must follow the appropriate toll design for that project. If a decision is taken to set tolls for a project on a stand-alone basis if it proceeds, it is not logical to allow the costs to be included in the general revenue requirement if the project is aborted.

## **Decision**

**While the Board is not proposing to disallow any of the internal costs related to the two projects under review for the test year it directs IPL that, in future, all costs, both internal and external, related to the preliminary investigation of a project must be tracked and the details provided when applying for the recovery of these costs.**

### **9.1.6.2 Edmonton NGL Project**

IPL took the position that incurring preliminary investigation costs in a prudent manner to examine the feasibility of providing requested transportation service was

consistent with its common carrier status. The Edmonton NGL project would have, in IPL's view, provided benefits to all system shippers, and the recovery of out-of-pocket costs should be included in the Applicant's cost of service. IPL referred to the RH-3-90 proceedings which demonstrated that there were available supplies of NGL, a demand for NGL and its products in Eastern Canada, and a need for a common carrier, open access facility to transport these volumes to market.

IPL also felt that the incremental increased volumes would have contributed to lower system tolls.

IPL acknowledged that in April 1991, the Board ruled that the proposed NGL receipt facilities at Edmonton should be tolled on a 100 percent stand-alone basis, but pointed out that subsequent studies showed that using average fuel and power costs for the incremental volumes would have provided a positive contribution to the Older System.

IPL maintained that it would not have been engaging in a new business activity but it was part of their common carrier obligation to consider the extension of the NGL service presently provided.

IPL pointed out that CPA supported IPL's position with respect to the proposal to recover the preliminary costs associated with the Edmonton NGL project. IPL noted that CPA acknowledged the project might have been of some marginal benefit to tollpayers generally. However, IPL were cognizant of CPA's concern with IPL attempting to recover all of the costs from its existing shippers.

CPA recommended that IPL be permitted to recover 10 to 40 percent of the costs related to the Edmonton NGL project with emphasis on the lower end. CPA did note, however, that it seemed strange that a project that was approved on a stand-alone toll basis would now be before the Board to have its preliminary investigation costs rolled into the Older System tolls on an integrated basis.

IPAC took the position that none of the costs related to this project should be included in IPL's test-year cost of service and the full amount should be disallowed. IPAC also noted that IPL agreed that, had the project proceeded, it would have been tolled on a stand-alone basis and the preliminary investigation costs would have been borne solely by the respective sponsors.

CanStates supported the inclusion of the preliminary investigation costs for the Edmonton NGL project in IPL's cost of service for the test year as it was of the view that the investigation work would benefit all shippers.

SaskOil supported IPAC's views with respect to the disallowance of the full costs.

SOLIGAZ supported the inclusion of the Edmonton NGL project preliminary investigation costs in IPL's test-year cost of service for similar reasons as those put forward by IPL.

APMC opposed the recovery through tolls of any portion of the preliminary investigation costs. APMC is of the view that the Edmonton NGL project would have benefited only one class of shipper and would have constituted a new and different service.

## **Views of the Board**

The Board is of the view that given its review of the Edmonton NGL project and decision in RH-3-90 that this project should be tolled using a stand-alone methodology, there is no basis for allowing any of the external costs related to this project in the test-year tolls. While the record indicates that there might have been some benefit for the Older System, any such benefits are balanced by the Board's decision not to disallow any of IPL's internal costs.

### **Decision**

**It is the Board's decision that none of the applied-for preliminary investigation costs related to the Edmonton NGL project are to be included in the test-year cost of service. In making this decision the Board notes that the changes to the treatment of preliminary investigation costs are being made on a prospective basis, and it has therefore not disallowed internal costs on this project. However, in future such costs are to be identified and may be disallowed.**

### **9.1.6.3 SOLIGAZ Project**

IPL was of the view that all of the preliminary investigation costs related to the SOLIGAZ project should be recovered.

As was the case for the Edmonton NGL project, IPL was of the view that the SOLIGAZ Project would have provided benefits to all system shippers.

IPL asserted that the SOLIGAZ project would have provided incremental throughput from Edmonton to Montreal, thus contributing to the lowering of the Older System tolls. Further, Western producers would have had access to broader markets for their NGL.

IPL also reasserted that it did not feel the SOLIGAZ project represented a new business activity and that it was part of its common carrier obligation to examine the feasibility of an extension to the existing NGL service provided. Also, the line could have transported refined products from Ontario refiners to Montreal markets as well as NGL specification propane and butane.

CPA was of the view that none of the costs related to the SOLIGAZ project should be permitted to be recovered. In its view, this project was "a second kick at the cat" and the same project for which IPL has already recovered costs in its prior years tolls.



CPA was also of the view that no supply data had been submitted to support the incremental volume benefit alluded to by IPL. CPA further expressed doubt that the investigation of the SOLIGAZ project would have added materially to IPL's ability to deal with NGL matters. IPL has been shipping NGL on its system for about 15 years.

IPAC took the position that none of the costs related to the SOLIGAZ project should be recovered. IPAC also suggested that either IPL or the project sponsors must assume financial responsibility for the work performed. In fact, IPAC is of the opinion that IPL recognizes the risk and protects itself with the agreements it enters into with project sponsors for recovery of the costs if the Board disallows them.

SaskOil was in agreement with IPAC's views on this issue and felt that if a project does not proceed, IPL must remain at risk for these costs, not the general system shipper.

SOLIGAZ strongly endorsed the inclusion of the costs related to the SOLIGAZ Project and supported the views presented by IPL on preliminary cost agreements with project sponsors, incremental volumes, common carrier obligation and the benefits which would have accrued to the Older System shippers. In argument, SOLIGAZ also recited several past Board decisions wherein all or part of the preliminary investigation costs have been approved.

SOLIGAZ refuted the argument that this project was an extension of a previous study performed by IPL. It was the view of SOLIGAZ that there were distinct differences. The first project was for SOQUIP and the study examined the feasibility of converting Line 9 to allow the transportation of NGL. The second project, the one currently under review, was a study of the feasibility of shipping NGL to Montreal via a new line from Westover to Montreal and by using Line 8 which would be converted for high vapour pressure service from Sarnia to Westover. SOLIGAZ strongly asserted that in its view these were not the same projects and definitely not an attempt to recover costs a second time as suggested by CPA.

APMC opposed the recovery of any costs of this project through the tolls for the test year. APMC also could not support IPL's first attempting to extract preliminary investigation costs through tolls before calling upon the project sponsors.

Quebec found that it was entirely reasonable that IPL recover, through tolls, the costs of this project, which would have permitted access to the resources in western Canada. Quebec cited the same arguments for inclusion as put forward by IPL and SOLIGAZ.

## **Views of the Board**

The Board is of the view that had this project advanced it would have been a new service and would have been tolled on a stand-alone basis. In keeping with its decision for the Edmonton NGL project preliminary investigation costs, the Board is

disallowing the external costs related to the SOLIGAZ project and reiterates its view on not disallowing the internal costs for the reasons previously cited under sections 9.1.6.1 and 9.1.6.2

### **Decision**

**It is the Board's decision that none of the applied-for preliminary investigation costs related to the SOLIGAZ project are to be included in the 1992 test-year cost of service. In making this decision, the Board notes that the changes to the treatment of preliminary investigation costs are being made on a prospective basis and it has therefore not disallowed internal costs on this project. However, in future such costs are to be identified and may be disallowed.**

### **9.1.7 Head Office Rent**

The question of the increase in head office rent expense being requested by IPL for 1992 test year was raised during the hearing.

IPL argued that the increase in the rent expense was primarily due to a rental increase in accordance with the terms of IPL's lease agreement for the IPL Tower.

IPL noted that the original lease was approved by the Board for calculating its rent expense in RH-4-86 and the subsequent leases were negotiated at normal commercial terms at market rates, including a rent-free period and tenant inducements for leaseholds. IPL noted that at the time of the original lease it was a landlord's market and that long-term leases without renegotiation clauses were very common.

IPL refuted IPAC's view that IPL should have split up its head office to take advantage of spot rates. IPL noted that neither TCPL nor the Board implemented such an option when moving their head office operations to Calgary.

It was pointed out by IPL that the only comparable space, given IPL's size, would have been the City Centre and the rental rate at that location would be \$24 per square foot as compared to the 1992 weighted average of \$22.90 per square foot in the IPL Tower. IPL suggested that it would not be fair, just or reasonable to use hindsight to compare past rates with current spot rates.

CPA agreed with IPAC that IPL should consider renegotiating its lease since IPL is in the latter stages of the lease. CPA suggested that a negotiation to extend the term, and commercial arrangements conducted by an impartial third party might be warranted.

IPAC suggested that the fundamental issue to be addressed by the Board in determining the relevant level for rent expense is the prudence of IPL in incurring

the projected level of rental expense. IPAC noted in response to the question about the Board using hindsight, that IPL itself acknowledged that it bears the risk and the consequences of being judged after the fact. IPAC suggested that in many cases it is only after the fact that the prudence of IPL's actions can be assessed.

IPAC disputed IPL's claim that the prudence of the original lease was assessed and determined as part of the RH-4-86 Reasons for Decision as set out on pages 27 and 28 of that decision. IPAC was disturbed to learn that IPL, the tenant had not raised the issue of renegotiation with IPL, the landlord.

IPAC was of the view that IPL should bear the consequences of what IPAC considers a bad management decision in not having a renegotiation clause in its original lease.

IPAC further suggested that IPL should be directed to conduct a market survey of comparable rental rates in the city of Edmonton and that the Board should disallow all rental expense in excess of the market level determined from the survey for the test year and subsequent years' revenue requirements.

IPAC did not believe that such a decision would have the effect of abrogating the lease arrangement between IPL, the tenant, and IPL, the landlord.

No other party presented argument on this issue.

## **Views of the Board**

While the Board is cognizant of the points brought forward by the intervenors, it also recognizes that the rental expense requested by IPL is pursuant to a lease agreement entered into some years ago. The terms and conditions of the lease were readily available for scrutiny and debate by all parties in RH-4-86 and in subsequent Class 2 Toll applications but were not challenged until this hearing.

The Board also acknowledges that IPL entered the initial lease agreement in a landlord's market and notes that IPL did not become full owner of the IPL Tower until after the lease was already in effect. The Board is of the view that it would be difficult, even using hindsight, to classify the decision as imprudent considering the rental market at the time the lease was entered into.

The Board does agree with CPA's position that IPL should use its best efforts to renegotiate the lease so that it would be more reflective of today's rental markets bearing in mind that IPL is the major tenant of the IPL Tower and is also the landlord. In all likelihood this arrangement will remain so and this should give IPL, the tenant some leverage in this regard.

## **Decision**

**The Board accepts the rental expense requested by IPL for the 1992 test year but strongly urges IPL to attempt to renegotiate its lease**



and to provide the Board with complete documentation of such attempts as part of any toll application for 1993. The Board, however, does not agree with IPAC's suggestion that it direct IPL to conduct a market survey and ,therefore, does not so direct.

### **9.1.8 Hearing Costs**

IPL requested that the Board approve a forecast amount of \$1 million for rate hearing costs in 1992 and requested that these costs be amortized over 2 years.

IPL later amended the above position and proposed that the Board approve an amortization of \$500,000 for the test year and that the actual total rate hearing costs less the \$500,000 amortization allowed in 1992 be brought forward and amortized in 1993. IPL preferred this method as it indicated that it had no control over the length or the final actual cost of the hearing and this would be a fair way to treat IPL, the shareholders and the shippers.

CPA, while not disagreeing with the amount with respect to the hearing costs, suggested that, given its recommendation for a stand-alone toll methodology for the Montreal Extension, a portion of the costs should be allocated to the Extension. CPA suggested that a 50-50 split would not be out of order.

IPAC concurred with CPA's suggestion of allocating a portion of the hearing costs to the Montreal Extension and suggested hearing days could be a basis for the allocation.

No other intervenor disagreed with IPL's request.

### **Views of the Board**

The Board agrees with the CPA that a portion of the hearing costs should be allocated to the Montreal Extension in light of its decision that the Extension should be tolled on a stand-alone basis for the 1992 test year.

#### **Decision**

**The Board approves the recovery of \$500,000 in the test year for rate hearing costs and the balance of the difference between the actual costs incurred and the \$500,000 in 1993. The Board directs that in each year 50 percent of the amount recovered is to be allocated to the Older System and 50 percent to the Montreal Extension. In approving IPL's approach, the Board cautions IPL that it will be incumbent upon it to substantiate the final actual costs incurred as being reasonable before any additional amount will be approved for recovery in 1993.**

### **9.1.9 High Resolution Inspection Program**

During the three-year period 1989-1991, IPL conducted a special high resolution internal inspection and maintenance program for which it requested and received approval to recover estimated costs through its tolls for those years. This program was initiated to identify the level of the corrosion problem facing IPL on its system. For the 1992 test year, IPL requested approval of \$3,550,000 for internal inspection and \$2,310,000 for corrosion investigation and repairs.

IPL suggested that there is no need to use a historical average to forecast this expense since it now has some experience in using the high resolution inspection tool and is in a better position to forecast this cost.

Although none of the intervenors addressed this cost directly, IPAC advanced the view that the Board should scrutinize every item constituting IPL's revenue requirement and ensure that the requested amount has been fully justified, especially since IPL's approach appears to be that the amount approved for the previous year is automatically justified for the subsequent year.

### **Views of the Board**

The Board is concerned over the level of funds recovered by IPL through the tolls for this specific operating project versus the costs actually incurred. In the period 1989-1991, IPL received approval and recovered in tolls \$18,050,000 for internal inspection costs and \$7,830,000 for corrosion investigation and repairs. Over that same period IPL actually incurred costs of \$10,430,000 and \$2,816,000 for these areas respectively.

The Board is cognizant of IPL's assertions that some costs were incurred prior to 1989 and were not recovered, that lower data costs than anticipated were experienced, that there were lower critical sections requiring data analysis than anticipated and that a reduction in the per-mile inspection rate for the 1990 inspection program from British Gas Corporation contributed to the variance. They now believe that they can better forecast these costs.

After considering all of these factors, the Board is of the view that there has been a lack of reasonable internal control over the status and costs being incurred on such a large maintenance project which allowed such a wide discrepancy between the forecast and actual costs to accrue. The Board cannot see any justification for allowing IPL to recover in the 1992 test year any further amounts related to this operating project when it has already collected \$12,634,000 more in total from the shippers than it has spent. Even if the Board were to accept that some unrecovered costs had existed prior to 1989, it was not demonstrated by IPL that these would have been of sufficient magnitude to offset the over-collection to date and justify the Board approving a further \$5,865,000 as requested by IPL for the test year.

## **Decision**

The Board disallows IPL's request for \$3,550,000 related to internal inspection costs and \$2,315,000 related to corrosion and internal investigation repair costs and directs that the excess funds already collected for this purpose be used to carry out the proposed test-year inspection and repairs. The Board also directs IPL that the ongoing status and costs for future maintenance projects of this magnitude must be more strictly documented and controlled. The Board wishes to remind IPL that requests for recovery of funds through tolls for projects of this nature will be subject to the same accountability for prudence that capital projects receive.

### **9.2 Allocation of Costs to the Montreal Extension**

IPL filed a cost allocation review in response to an information request by the Board. The primary change between this review and the basis of cost allocations in 1986 centred around the allocation of costs to the idled Montreal Extension.

IPL noted that it has changed the factors used to allocate common operating costs to the Montreal Extension. The previous throughput-based factors are no longer applicable because the Montreal Extension is no longer in active service. If there were no change in the basis of allocation, there would be no allocation of common costs to the Montreal Extension. IPL proposed a time estimate for most of its Eastern Division Departments, with the exception of pipeline Maintenance Departments and the Eastern Division Right-of-Way Department, which will be allocated based on kilometres of pipe and kilometres of right-of-way, respectively.

No intervenor questioned IPL on these changes.

## **Decision**

The Board accepts and approves the allocation of the common operating costs to the Montreal Extension, in the manner described by IPL, for the 1992 test year.

### **9.3 Other Considerations**

IPAC indicated that it felt that the Board should direct IPL to use a "zero-based" justification approach in arriving at its test-year estimates rather than an incremental approach.

## **Views of the Board**

While this area was raised in argument by IPAC and was not responded to by IPL in rebuttal, the Board was not persuaded by the record that such a directive was



warranted or supported at this time. There was no evidence provided which would suggest that IPL's estimates would be any different if it had utilized the approach proposed by IPAC. However, the Board does expect positive efficiency results from IPL's introduction of its CIP to be reflected in subsequent years' estimates.

### **Decision**

**The Board denies IPAC's request that it direct IPL to use a "zero-based" justification approach in arriving at its test-year estimates.**

## Chapter 10

# Toll Design

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### 10.1 Introduction

Parties to this proceeding referred extensively to the toll design principles set out by the Board in IPL's last major toll case in 1986. In that hearing, the Board examined the appropriate toll methodology for new services, and the continuing appropriateness of tolling for an existing service. In RH-4-86, the Board stated that the two principles which should be adhered to in setting tolls for IPL are that tolls should be cost-based, and there should be no unjust discrimination. Further, any toll methodology should apply these principles in a consistent manner to meet the test of overall fairness. If possible, certain desirable attributes such as simplicity, stability, and predictability should be met. However, these objectives should not be met at the expense of compromising the principles of cost-based tolls and no unjust discrimination.

The Board recognized that, due to practical considerations and the limitations of cost allocation procedures, no toll will be completely cost-based. In other words, no toll will be able to precisely reflect all the costs associated with providing a particular service for a particular product. However, the Board stated that if the users of a system bear the financial responsibility for the costs caused by the transportation of their product through the pipeline, and if cross-subsidization is minimized, then tolls can be considered cost-based.

Regarding unjust discrimination, in RH-4-86 the Board stated that "the Board can set different tolls for traffic of different descriptions; for traffic of similar description but which is carried over different routes; as well as for traffic which flows under substantially different circumstances, all without offending the prohibition against unjust discrimination."

In RH-3-90, the Board found it appropriate to again set tolls having regard to the principles that were enunciated in RH-4-86.

All parties to this hearing argued that the Board should have primary regard to the principle of setting cost-based tolls in its decisions in this proceeding. In addition, some parties argued that economic efficiency should be another criterion in determining an appropriate toll design for IPL.

The Board believes that the characterization given to cost-based tolls in RH-4-86 is appropriate, that is, to the extent possible, customers should pay tolls which recover the full cost of the service provided. In addition, costs should be allocated to the users in proportion to their use of the service, thus ensuring that the concept of user pay is incorporated within the principle of cost-based tolls. Some parties have described user pay as a separate tollmaking principle or objective; however, the

Board views cost-based/user-pay tolls as a single tollmaking principle. If all reasonable efforts are made to minimize cross-subsidies and ensure that users pay for the costs they cause on the system, then the Board would consider the resulting tolls to be cost-based/user-pay.

The Board is also of the view that tolls should ideally be set to encourage economic efficiency. However, this could require that tolls be set to reflect the value of service, rather than reflecting the actual costs of providing the service. Thus, at times there may be a conflict between adherence to the principle of cost-based/user-pay tolls and promotion of economic efficiency. In such instances, the Board is of the view that there would have to be strong reasons for departing from the principle of cost-based/user-pay tolls in order to set tolls which would encourage economic efficiency.

In summary, the Board believes that in order to set just and reasonable tolls for IPL, the principles of cost-based/user-pay tolls and no unjust discrimination should be respected. If possible, the objectives of simplicity, stability and predictability should be met, but not at the expense of the principles. Further, tolls should ideally be set in order to promote economic efficiency. However, when there is a conflict between adherence to the principles of cost-based/user-pay tolls and setting tolls to promote economic efficiency, there would need to be strong reasons before the Board would depart from adherence to cost-based/user-pay tolls. Finally, consideration should be given to fairness for all of the parties affected by the decision.

## **10.2 Toll Methodology for the 1992 Test Year**

### **10.2.1 Older System and the Montreal Extension**

Appropriate toll methodology is determined by the Board during a Class 3 application.

In RH-2-76, the Board outlined a methodology for the calculation of tolls in respect of the Montreal Extension. Essentially, the Board set out two methods of calculation - an "integrated" method and a "two-part" method - and developed a test to determine which method would be appropriate for a given year. The method that would apply in any given test year would be that which would result in lower tolls for the Older System.

Until 1984, the tolls for the Montreal Extension were calculated using the two-part method of toll design. In its February 1984 Decision, the Board directed IPL to use an integrated toll design, on the basis that shippers on the Older System would pay lower tolls and that percentage changes in tolls would be more stable.

In RH-4-86, the Board found that the two-part versus integrated test was unfair and should be discontinued. Although the Board accepted the use of integrated tolls for 1987, it indicated that, given its views on toll design principles and objectives, it was not convinced that the integrated approach was necessarily the appropriate toll



design for the Montreal Extension and that this issue would be examined at the next Class 3 hearing.

Throughput on the Montreal Extension steadily declined from a peak of 49 000 m<sup>3</sup>/day in 1980 to an average of 13 300 m<sup>3</sup>/day in 1990. This decline has been attributed to the decreasing availability of Canadian light crude and the availability of lower priced offshore crude. Beginning in September 1990, three of the four remaining shippers ceased nominating for delivery on the Montreal Extension. In March 1991, the last shipper requested delivery of its line-fill from IPL. In late April, IPL began displacing the line-fill with nitrogen. This operation was completed in July 1991. The Montreal Extension remains idle to date and IPL is forecasting no throughputs for the 1992 test year.

In 1991, the Board approved a revenue requirement of \$21.0 million for the Montreal Extension. Only \$1.1 million was generated from throughput on the Montreal Extension. The remaining \$19.9 million was recovered from Older System shippers. Approximately \$10.9 million in additional fixed and variable costs, comprising those items which were disallowed by the Board for toll purposes, will be recovered from the Federal Government under the terms of the Montreal Extension Deficiency Agreement.

For the 1992 test year, IPL is requesting that the Board approve a revenue requirement for the Montreal Extension of \$23.8 million. As well, IPL is currently forecasting \$4.9 million in additional costs to be recovered through the Deficiency Agreement. Thus the total cost related to the Montreal Extension is approximately \$28.7 million.

Under an integrated toll design, the Older System shippers would pay tolls based on the recovery of the Older System net revenue requirement plus the \$23.8 million revenue requirement related to the Montreal Extension. The Federal Government would still be required to pay the \$4.9 million deficiency payment. However, under a stand-alone toll design, the Federal Government would be responsible for all costs related to the Montreal Extension, approximately \$28.7 million.

For the 1992 test year, IPL is requesting that the Board approve an integrated toll design for the Montreal Extension and the Older System.

IPL stated that the rationale for its position is based on criteria that have traditionally been applied by the Board to establish just and reasonable tolls. These criteria include toll design principles and objectives, and consideration of the physical and operational attributes of the facilities.

With respect to toll design principles and objectives, IPL stated that integrated tolls are cost-based. In regard to cost causality, the use of integrated tolls recognizes all costs on the system and allocates these costs on the basis of objective factors to all users of the system. IPL also stated that regulatory consistency requires that costs for the existing facilities should continue to be treated on an integrated basis.

With respect to fairness considerations, IPL indicated that the fairness of integrated tolls to all users of the system is based on the equality of treatment which all receive. IPL also noted that the use of an integrated toll design for the Montreal Extension avoids any increase in Federal Government contributions to the costs of oil shipments.

Five intervenors stated positions on toll design for the Montreal Extension in the 1992 test year. All of these intervenors indicated that a stand-alone toll design was more appropriate than an integrated toll design.

CPA stated that, with respect to minimizing cross-subsidies, it would be inappropriate to require the Older System shippers to subsidize the costs of the Montreal Extension while it is idle. Regarding fairness considerations, CPA argued that the Older System shippers should not be required to maintain the Extension for the benefit of future shippers on a reversed Extension. Finally, CPA stated that there is no reason why the Older System shippers should be required to subsidize a portion of the Federal Government's obligation under the Deficiency Agreement.

IPAC stated that when one applies the Board's toll design principles to the Montreal Extension, it is clear that any movements over that line should absorb the cost of such transportation. Only in this fashion will subsidization of these movements by Older System shippers be eliminated. Regarding fairness considerations, IPAC stated that it would be unfair for Older System shippers to absorb millions of dollars in costs to maintain the Extension and then see it converted to a competing use. IPAC also stated that it would be inappropriate to burden Western Canadian producers with the costs of the Montreal Extension, particularly in circumstances that the Deficiency Agreement itself was designed to cover.

SaskOil stated that the application of the just and reasonable principle leads to the conclusion that the Montreal Extension must be treated on a stand-alone basis. SaskOil also stated that to accept IPL's request to maintain integrated tolls on the basis of continuity and rate stability would allow one desirable tollmaking attribute to override the more important concept of fairness. With respect to operational integration, SaskOil does not believe that the integration of an idle or reversed Montreal Extension has been demonstrated by IPL.

Suncor Inc. ("Suncor") stated that stand-alone tolls must be applied to ensure that shippers on the Older System do not subsidize an idle Montreal Extension. Suncor believes this position is consistent with the economic principle of user-pay and cost-based tolls.

APMC stated that because the Older System shippers will receive no benefit from the Montreal Extension in 1992, it is unacceptable for them to continue to pay the costs of this pipeline while it is deactivated. APMC believed that cross-subsidies between two systems, regardless of the direction in which the cross-subsidy flows, are to be avoided. A stand-alone toll design would ensure that cross-subsidies would not occur.

In determining the appropriate toll methodology for an idle Montreal Extension in the 1992 test year the Board had primary regard to whether an integrated or stand-alone design would best adhere to the principle of cost-based/user-pay tolls. In addition, the Board considered the fairness of the toll design.

In determining which method best reflects cost-based/user-pay tolls, the Board had regard to three factors:

- 1) physical integration of the Older System and the Montreal Extension;
- 2) operational integration of the Older System and the Montreal Extension; and
- 3) nature of the service provided by the Montreal Extension.

#### **1) Physical Integration of the Older System and the Montreal Extension**

The first question that should be addressed is whether facilities are jointly used by many shippers and/or products, or whether they are separate-use facilities. When jointly used, it is difficult to allocate costs to individual shippers (or products) and it is usually necessary to allocate costs across all users and charge the same toll to all users of the joint-use facilities. However, when facilities are separated, and costs can be clearly allocated to particular shippers, the principle of cost-based/user-pay tolls is respected if these costs are allocated to those shippers who use the separately identifiable facilities.

Therefore, the Board considered the degree to which the facilities of the Montreal Extension and the Older System are jointly used, whether it is physically possible for customers to use one facility and not the other, and whether it is likely that most customers will use both facilities?

In the Board's view, the fact that the Extension is expected to be idle during 1992 and will have no discernible effect on the operation of the Older System, clearly demonstrates that the two systems will not be jointly used. Oil continues to reach IPL customers even with the Montreal Extension idled, illustrating the lack of physical dependence of one system on the other.

The Board is of the opinion that the Montreal Extension is more physically separate than integrated with the Older System.



## **2) Operational Integration of the Older System and the Montreal Extension**

In assessing the degree to which operational integration is present, the Board considered whether or not the facilities can be operated independently and to what degree in terms of day-to-day operations and financial management.

In order to assess the degree of operational integration of the Older System and the Montreal Extension, the Board took into account IPL's internal management policies and practices, the implications of the Montreal Extension Deficiency Agreement and the impact of a change in the status of the Montreal Extension on IPL's day-to-day operations.

The Board concurs with IPL that it has demonstrated that operational integration is practiced to some extent. However, the Board is also of the view that the Montreal Extension has been operated under a different set of circumstances because of the Deficiency Agreement. In this context, separate accounting for all costs and the allocation of common costs between the Older System and the Montreal Extension have been required since the inception of service on the Montreal Extension.

Regarding the impact of idling the Montreal Extension on IPL's day-to-day operations, the Board notes that the Applicant has indicated there has been little effect on operations. In the Board's view, this indicates that the two systems are not operated on a fully integrated basis.

## **3) Nature of the Service Provided by the Montreal Extension**

After considering the degree of physical and operational integration of the facilities, the Board examined the nature of the services provided by the Older System and the Montreal Extension. The Board had regard to whether the facilities provide a similar type of service (e.g. transportation, storage) and to whether the facilities provide service for similar products (e.g. light crude, heavy crude, refined products). In addition, the Board considered whether a new and different service is being provided by the facilities.

For the 1992 test year, it is highly unlikely that there will be any oil transported on the Montreal Extension. Clearly, this lack of service on the Montreal Extension is distinct and separate from the transportation service which continues to be provided on the Older System.

In summary, the Board is of the view that the Montreal Extension and the Older System are not physically integrated, nor are they fully integrated from an operational standpoint. In addition, the costs associated with each system can be clearly attributed to the users of each system. In these circumstances, the Board is of the view that the principle of cost-based/user-pay tolls is best respected by a stand-alone toll design for the Montreal Extension.

In addition to adherence to the principle of cost-based/user-pay tolls, the Board had regard to the fairness of setting a stand-alone toll. In the view of the Board, it would be unfair if Older System shippers were required to pay for costs to maintain the Montreal Extension while they receive no benefits. The Board is also of the view that, while there are no throughputs on the Montreal Extension, the Federal Government should be responsible for all costs of the Montreal Extension as provided for in the Deficiency Agreement. Therefore, the Board is of the view that a stand-alone toll for the test year would meet the test of fairness.

## **Decision**

**For the 1992 test year, the Board rules that a stand-alone toll design is more appropriate than an integrated toll design. Accordingly, IPL is directed to calculate tolls for the Montreal Extension and the Older System on a stand-alone basis.**

### **10.2.2 Clarkson Lateral**

The Clarkson Lateral was constructed in 1984. It cost approximately \$11 million and covered 13.2 kilometres between the Gulf refinery (now Petro-Canada), located at Clarkson, and the Montreal Extension.

Prior to its construction, the Board received an application from IPL to approve an integrated toll design for this facility. The Board subsequently approved the proposed integrated toll design for the Clarkson Lateral and allowed IPL to include the capital costs of this project in the Older System rate base.

In making a toll design ruling on the proposed NGL facilities in Edmonton, the Board stated in RH-3-90 that it was aware of examples of facilities where costs are rolled in but which are used by a single commodity group or are essentially single-user facilities. The Board stated that it was prepared to examine, at a future Class 3 Toll hearing, the status of existing facilities. The Board went on to state that it would consider the appropriateness of continuing to toll these facilities under the existing methodology.

The Clarkson Lateral Deficiency Agreement was signed by IPL and Gulf Canada Resources Limited ("Gulf") prior to the construction of the Clarkson Lateral. This agreement guaranteed that Gulf would ship a minimum of 1 190 000 m<sup>3</sup> in each year for a period of 15 years.

The volumes actually shipped have never reached this threshold and have declined in each year since the Agreement went into effect. In 1991 there were no volumes shipped and for the 1992 test year, because of the closure of the Montreal extension, no volumes will move through the Clarkson Lateral.

For the 1992 test year, the net revenue requirement for the Clarkson Lateral is approximately \$1.8 million. During the hearing, IPL indicated that the final determination of the deficiency payment will be done once the Board issues its decision in this proceeding. IPL and Petro-Canada are currently negotiating a final settlement to the Clarkson Lateral Deficiency Agreement. As an interim settlement, Petro-Canada has agreed to pay \$1.8 million to IPL to cover all costs associated with the Clarkson Lateral in 1992. IPL has in turn agreed to credit this amount in full to the Older System revenue requirement.

IPL considers that the Clarkson Lateral should continue to be tolled on an integrated basis with the Older System. Its position is essentially based on consistency with past tolling decisions. For the 1992 test year, IPL stated that it is premature for the Board to consider a change to the present Older System rate base treatment, pending the finalization of a decision on the reversal of the Montreal Extension. IPL also stated that pending that finalization, the position of the shippers is protected by the inclusion of the \$1.8 million in the Company's revenue.

IPAC and APMC argued that the appropriate toll design for the Clarkson Lateral was stand-alone. Their rationale focused on the fact that the Clarkson Lateral was constructed as a single-user facility. APMC and SaskOil requested that the Board instruct IPL to remove the Clarkson Lateral from the Older System rate base. APMC stated that the line is not currently used and useful and that the prospect for use of the Clarkson Lateral by Older System shippers appears, at this time, to be remote at best. SaskOil maintained that the Older System is at risk until the Clarkson Lateral can be handed over to another use and therefore should be out of rate base until this should occur.

The Board recognizes that the Clarkson Lateral was constructed essentially as a single user facility. The Board also is aware that IPL required additional guarantees against risk in the form of the Clarkson Lateral Deficiency Agreement. The Board notes that Petro-Canada has already agreed to pay the costs of maintaining the Lateral for 1992 and that a final settlement to the Clarkson Lateral Deficiency Agreement is still being negotiated.

### **Decision**

**The Board does not believe that it is appropriate to make a decision on whether or not to remove the Clarkson Lateral from rate base or to change the toll design for the Clarkson Lateral at this time given the uncertainty surrounding the Montreal Extension and the ongoing negotiations regarding the Clarkson Lateral Deficiency Agreement. The Board directs IPL to file a detailed schedule showing the costs of maintaining the Clarkson Lateral for the 1992 test year which reflect these Reasons for Decision. The Board also directs IPL to apply the entire 1992 Clarkson Lateral Deficiency payment to the Older System's revenue requirement.**



### **10.2.3 Update to the Toll Design Study**

In the Board's November 1989 Reasons for Decision ("RHW-1-89"), the Board ruled that IPL be required to update the integrated surcharge calculations every two years or earlier if so requested by the Board, or if there were significant changes in the factors which underlie the calculations.

In response to this requirement, IPL submitted an Update to the Toll Design Study as part of RH-2-91. The only change to the level of the surcharges was from 11 percent to 10 percent for the NGL transmission surcharge credit.

IPL stated that the transmission surcharges resulting from the Updated Study should be approved. In addition, IPL argued that the requirement to update these surcharges every two years is too onerous and should be changed. Specifically, IPL proposed that a review should only be undertaken upon request from industry or if, in IPL's assessment, there have been significant changes in the input factors affecting surcharge levels.

No intervenors commented on the level of surcharges, or on IPL's request to change the procedure for updating these surcharges in the future.

#### **Decision**

**The Board approves the transmission surcharges as submitted. The Board also agrees with IPL's proposal to change the requirement for updating these surcharges. Accordingly, IPL is directed to update the calculation of these surcharges only on the basis of a request from either industry or the Board or if IPL feels there have been significant changes in the input factors which underlie these surcharges.**

### **10.3 Toll Methodology for a Reversed Montreal Extension**

In its Application, IPL requested that the Board consider the appropriate toll design for the possible reversal of the Montreal Extension. This pipeline reversal is being contemplated as a result of the declining supplies of Western Canadian light crude oil, and the increasing competitiveness of offshore crude in the Ontario market. Different toll designs can have a significant impact on the resulting level of tolls and are an important consideration when assessing the economic viability of the reversal project.

The construction of additional facilities would be required to effect the reversed flow on the pipeline. IPL in its application, estimated that the capital cost of the reversal facilities would be approximately \$27 million. However, it became apparent during the hearing that depending on various design and throughput factors, costs of the reversal facilities could exceed \$100 million. IPL has indicated that there could be a

need for offshore crude oil to be transported through the pipeline as early as 1994. Prospective Shippers have indicated a target date of early 1994 to begin shipping oil in an east-to-west direction on the Extension. Some interested parties, in particular Suncor, disputed the timing of the need for east-to-west shipments.

As established by the amending Hearing Order, an issue to be addressed in this hearing was "an examination of the appropriate treatment of the estimated costs related to and the appropriate toll design methodology for the scenario where the Montreal Extension would be reversed to allow east-to-west movements of crude oil". Interested parties submitted their views on a number of other issues related to the Montreal Extension, such as: the need for reversal, the cost of the proposed facilities, estimated throughput on the reversed Extension and environmental implications. The Board permitted this discussion to allow intervenors latitude in their arguments for toll design. However, the decisions of the Board at this time relate specifically to toll design. Further discussion of these other issues would occur as part of an application for reversal facilities.

The Board recognizes the key role that toll design can play in determining the economic viability of a project and accedes to IPL's request for a determination of the appropriate toll design for the reversed Montreal Extension in advance of proceeding with an application to construct facilities. However, the Board's decision on toll design for a reversed Montreal Extension should in no way be perceived as an indication that the reversal facilities will be approved by the Board in the future. If IPL chooses to proceed with the project, based on the toll design indicated in this decision, the Board will expect to receive a full record on the need for and the timing of the reversal in a facilities hearing.

In order to determine the appropriate toll design for the reversed Montreal Extension, the Board first considered whether the toll design should be stand-alone, integrated, or a combination of the two methodologies. Then, the Board considered the revaluation of the rate base of the Montreal Extension as proposed by several intervenors. The Board considered the issue of stand-alone tolls versus some form of integrated tolls to be separate from the issue of rate base valuation. Although the two issues are linked in the toll proposals of several intervenors, the Board believes that these issues require separate analysis.

### **10.3.1 Toll Design for a Reversed Montreal Extension**

In the event that the Montreal Extension is reversed, IPL proposed that the existing facilities of the Montreal Extension be tolled on an integrated basis with the Older System, and that there be an additional surcharge for the facilities which would be built to effect the reversal. IPL's proposal for reversal included facilities that would allow the Extension to be re-reversed (for a discussion of re-reversal facilities see section 10.4). If re-reversal facilities were constructed at the same time as reversal facilities, the Montreal Extension would be available for the movement of oil in either an east-to-west direction, or a west-to-east direction. Under IPL's hybrid approach for toll design, all shippers using the Montreal Extension would make

equal contributions to the existing rate base, and east-to-west shippers would pay an additional surcharge for facilities which are used exclusively in the reversed mode.

With respect to the toll design principles of cost-based tolls and no unjust discrimination, IPL stated that its proposed toll design would be cost-based because tolls would be based on the actual embedded costs of the Montreal Extension and the future costs of the facilities required for the reversal. IPL argued that tolling the new facilities on a stand-alone basis is consistent with the concept of user pay. According to IPL, in order to ensure that future tolls are non-discriminatory, use of the existing facilities should be provided to east-to-west shippers at the same cost as service was previously provided to west-to-east shippers. In summary, IPL argued that its proposed toll design would result in tolls which are cost-based, respect the concept of user pay, and avoid unjust discrimination.

IPL further argued that the Montreal Extension rate base is a mature component of IPL's total system rate base and, in order to ensure regulatory consistency, costs for the existing facilities should continue to be treated on an integrated basis. IPL stated that the appropriateness of continuing the integrated toll methodology is supported by the integrated nature of potential future operations. The Older System and the Montreal Extension overlap for about 23 percent of the total distance covered by the Montreal Extension, and the two systems would use many common facilities, regardless of the direction of flow on the Montreal Extension. If the Montreal Extension is reversed, IPL stated that it would continue to use the integrated approach it applies to the operation and management of its pipeline system.

None of the intervenors supported IPL's proposed toll design for the reversed Montreal Extension. Quebec argued that fully integrated tolls should be continued, while CPA, IPAC, the Prospective Shippers, Suncor, and APMC supported stand-alone tolls.

With fully integrated tolls, all the costs of the Montreal Extension, as well as the costs of new facilities built for the reversal, would be included with the costs of the Older System for tollmaking purposes. Quebec argued that fully integrated tolls would be appropriate because the Montreal Extension and the Older System would be physically integrated, some facilities would be shared between the two systems, and they would be operated and managed on an integrated basis.

On a stand-alone basis, the tolls for the reversed Montreal Extension would be set on the basis of the costs associated with the existing Montreal Extension facilities plus the costs associated with the new facilities required for the reversal. All the parties who supported stand-alone tolls indicated that they relied on the Board's tollmaking principles enunciated in RH-4-86 in determining that stand-alone tolls are appropriate.

CPA argued that the rate base of a reversed Montreal Extension should be revalued and should be tolled on a stand-alone basis because the Extension and the Older System are not integrated in an operational sense. CPA emphasized that a reversed



Montreal Extension would represent a new service transporting oil from a different source in a different direction and the Montreal Extension should therefore be viewed as competing with the Older System and not integrated with it. In order to ensure that shippers on one system do not subsidize their competitors on the other system, stand-alone tolls should be implemented.

IPAC stated that before deciding whether rolled-in or stand-alone tolls are appropriate for the reversed Montreal Extension, the Board should first determine the appropriate amount of costs to be included in the rate base. IPAC argued that stand-alone tolls should be calculated for the reversed Extension based on IPAC's proposal for a fair value rate base. According to IPAC, the most important reason for implementing stand-alone tolls is to avoid cross-subsidization between the Older System and the Montreal Extension. IPAC noted that IPL acknowledged that cross-subsidization would occur under IPL's proposed toll design, and the Board explicitly stated in RH-4-86 that cross-subsidization, even if it is temporary, is not desirable.

IPAC also stated that the reversed Montreal Extension would be providing a new service with no operational benefits for Older System shippers, such as increased flexibility and reliability that would normally be associated with an integrated pipeline system.

The Prospective Shippers stated that service on the reversed Montreal Extension would be separate and distinct from service on the Older System. Further, the reversed Montreal Extension will provide no service to Older System shippers. For these reasons, and to be consistent with the tollmaking principles of setting tolls on a cost-based/user-pay basis as outlined by the Board in RH-4-86, the Prospective Shippers stated that stand-alone tolls are both appropriate and reasonable.

SaskOil submitted that the reversed Extension would be providing a new service and, in order to achieve just and reasonable tolls, the Montreal Extension must be tolled on a stand-alone basis.

APMC advocated a stand-alone toll design for the reversed Montreal Extension based on a revalued rate base. APMC argued that the reversed Montreal Extension would not be integrated operationally with the Older System, and it would provide no benefit to Older System shippers. In order to satisfy the tollmaking principles of setting cost-based and user pay tolls, the APMC stated that stand-alone tolls must be implemented for the Montreal Extension.

It was Suncor's view that it is premature to decide on the appropriate toll methodology for the reversed Montreal Extension. Suncor stated that there is not enough information available at this time to make a decision on toll design which takes into consideration the effects on all parties, in particular the costs which may be transferred to Older System shippers if the Montreal Extension is reversed. However, Suncor stated that if a decision on toll design is made at this time, the Montreal Extension should be revalued and it should be tolled on a stand-alone basis in order to avoid cross-subsidization and to be consistent with the principle of user pay and cost-based tolls.

Finally, several parties also commented on IPL's claim that integrated tolls are warranted in part because there is the possibility for optimization of the system by using a portion of the Extension in Older System service. They argued that the optimization proposal is not sufficient evidence to indicate operational integration, and that it does not justify integrated tolling.

In order to determine which toll methodology is more appropriate for the reversed Montreal Extension, the Board again relied on the toll principles established in RH-4-86. In particular, the Board had regard to the principle of cost-based/user-pay tolls.

In determining which toll methodology would best adhere to the principle of cost-based tolls, the Board relied on the framework outlined in section 10.2.1; that is, the Board considered the physical and operational integration of the Montreal Extension and the Older System, and the extent to which service on a reversed Montreal Extension is different from service on the Older System.

### **1) Physical Integration of the Older System and the Reversed Montreal Extension**

The issue to be considered with regard to physical integration is the extent to which the Older System and the reversed Montreal Extension will be jointly used.

Under the reversal scenario it will always be physically possible for shippers to use one facility and not the other. Although it is possible, or perhaps even likely, for some Sarnia refiners to ship oil on both systems, Suncor is a good example of a shipper on the Older System who may not use a reversed Montreal Extension.

IPL has indicated that there are some facilities, such as the Nanticoke Lateral, which will be used by shippers on the Older System and shippers on the reversed Montreal Extension. However, the Board is not convinced that joint-use of some of IPL's facilities necessarily leads to the conclusion that the reversed Montreal Extension is physically integrated with the Older System.

The Board is of the view that, on balance, the reversed Montreal Extension should not be considered physically integrated with the Older System because it would be possible to use the Older System and the reversed Montreal Extension separately, and there would be an identifiable (although not necessarily unique) group of customers for each system. On the basis of the limited degree of physical integration, stand-alone tolls should be implemented in order to respect the principle of cost-based/user-pay tolls.

## **2) Operational Integration of the Older System and the Reversed Montreal Extension**

IPL has indicated that if the Montreal Extension is reversed, several aspects of the Extension and the Older System would continue to be managed and operated jointly. For example, maintenance, scheduling, engineering and technical support, operations control, and administrative services would continue to be provided jointly for both systems.

The Board notes that, because of the Deficiency Agreement, IPL has operated the Montreal Extension under a different set of terms and conditions than the Older System. In addition, IPL has always allocated costs separately for the Montreal Extension which indicates that not all aspects of the systems are operated jointly. The Board believes that if the Montreal Extension is reversed, any operational integration that occurs between the Older System and the Montreal Extension would occur primarily as a result of joint ownership, and secondarily as a result of the need to coordinate the activities of some parts of the systems.

Although some form of integrated tolls may be more convenient for IPL, the Board does not believe that IPL would be unduly restricted in its operations with stand-alone tolls. Further, since costs are already allocated separately to the Montreal Extension, stand-alone tolls should not prevent IPL from continuing its current approach to operations.

## **3) Nature of the Service Provided by the Reversed Montreal Extension**

Both the reversed Montreal Extension and the Older System would be providing the same type of service for similar products, that is, shipping crude oil. However, there was general agreement among the intervenors and the Applicant that shipping oil from Montreal to Sarnia would be a new service on IPL's system.

The Board agrees that reversing the Montreal Extension could be viewed as a new service and, as a result, there are two conclusions which the Board has drawn. First, stand-alone tolls would be more appropriate for the reversed Montreal Extension in order to respect the principle of cost-based/user-pay tolls as the users of the new service should bear the financial responsibility for the service. Second, provided all shippers on the reversed Montreal Extension are subject to the same toll structure, the principle of no unjust discrimination will be respected. The Board believes that the Montreal Extension will only be reversed in response to economic pressures, unlike the original service on the line which was provided to meet Federal Government policy objectives. East-to-west service would be provided in substantially different circumstances than service was provided in a west-to-east direction and, therefore, the principle of no unjust discrimination does not preclude the use of stand-alone tolls for the reversed Montreal Extension.

In summary, after considering the degree of physical and operational integration of the Montreal Extension with the Older System and considering the nature of the



service that would be provided on a reversed Montreal Extension, the evidence supports the principle that cost-based/user-pay tolls would best be respected if the Montreal Extension is tolled on a stand-alone basis.

With respect to fairness considerations, the Board notes that parties representing Western Canadian producers argued that if the Montreal Extension is reversed, they would be adversely affected by integrated tolls because shippers on the Older System would be forced to support shippers on the Montreal Extension without receiving any benefit from the Montreal Extension. The Prospective Shippers also argued for stand-alone tolls. Therefore, it seems clear that both producers and refiners believe that stand-alone tolls would be fairer. Based on the evidence presented, the Board is of the view that stand-alone tolls would be the fairest solution for affected parties.

With respect to economic efficiency, the Board is of the view that tolling the Montreal Extension on a stand-alone basis will send the appropriate price signals to potential users of a reversed Montreal Extension and will therefore promote appropriate decision making by shippers.

The Board notes that stand-alone tolls will not be unduly complex and, hence, the objectives of simplicity and administrative feasibility will also be satisfied.

In conclusion, the Board is of the view that stand-alone tolls would best satisfy the principle of cost-based/user-pay tolls, would promote economic efficiency, would be fair to all shippers and would not be difficult to implement or administer.

## **Decision**

**In the event that the Montreal Extension is reversed, tolls for the Montreal Extension will be set on a stand-alone basis. The tolls will be calculated on the basis of the costs of the existing Montreal Extension facilities, plus the costs associated with facilities built to effect the reversal of the line.**

### **10.3.2 Rate Base Valuation**

Rate base valuation was not specifically listed as an issue to be addressed in the hearing. However, following the submission of the intervenors' written evidence, the issue of revaluing the rate base of the Montreal Extension attracted a great deal of attention, both in the written and oral evidence.

Revaluing the rate base of the Montreal Extension was proposed by several intervenors because of its unique history and, more specifically, because of the terms of the Montreal Extension Deficiency Agreement. As a result of the Deficiency Agreement, IPL was permitted to depreciate the rate base of the Montreal Extension at a rate of 5 percent per year. As a result of the use of this depreciation rate the Montreal Extension will be fully depreciated by 1996. The 5 percent depreciation rate has been characterized as an accelerated depreciation rate because

other pipelines are traditionally depreciated on the basis of a 35 year life, that is, at a rate of 2.86 percent per year.

In order to be consistent with the terms of the Deficiency Agreement, the Board permitted the rate base of the Montreal Extension to be depreciated at the 5 percent annual rate. However, since RH-2-76 the Board has maintained that tolls for the Montreal Extension should be calculated on the basis of a 2.86 percent depreciation rate for the rate base. As a result of the financial support arrangements for the Montreal Extension in the Deficiency Agreement, the Federal Government has paid the approximately 2 percentage point spread between the 5 percent depreciation calculated for rate base purposes and the 2.86 percent depreciation expense collected through tolls. The proposals for revaluation of the rate base are based, at least in part, on the recovery of the accelerated depreciation payments which have been made by the Federal Government as part of the annual deficiency payments to IPL.

CPA and APMC argued that the rate base of the Montreal Extension should be revalued to reflect the original cost of the pipeline, less the accumulated depreciation allowed by the Board to date for ratemaking purposes. In other words, they argued that the rate base should be revalued to include the costs of the accelerated depreciation that were paid by the Federal Government.

CPA argued that revaluation is necessary to ensure that tolls are based on the real cost of transportation and to ensure that the price signals sent to shippers on a reversed Extension correctly reflect the real cost of providing this service. Unless the Board revalues the rate base, CPA and APMC argued that the distortions caused by the past Government subsidies will be carried forward into the prospective tolls.

In argument, CPA noted that the Board has never approved the 5 percent depreciation rate for the rate base. Instead, the Board has simply complied with the conditions of the Deficiency Agreement. Therefore, in CPA's view, it would not be inconsistent with past toll practices for the Board to add the deficiency payments back into the rate base.

APMC argued that without revaluation of the rate base, potential shippers on the reversed Montreal Extension would be given an unfair competitive advantage compared to Older System shippers. APMC urged the Board to let the propositions of cost recognition and responsibility for costs prevail by recognizing the real cost of providing service on the reversed line.

IPAC argued that when determining a value for the rate base of the reversed Montreal Extension, the Board should be guided by the consideration of fairness. IPAC advocated revaluing the rate base in order to adjust fairly for past subsidies, and to put all market participants on an equal footing. IPAC suggested that the level of revaluation should be based on the Trended Original Cost Less Depreciation methodology. IPAC proposed that this be accomplished by employing an index to bring the construction costs to current levels. Then, the age and condition of the asset would be recognized by applying the normally accepted depreciation rate (i.e. 2.86 percent) to the higher base cost.

In IPAC's view, there are two reasons why a revaluation of the rate base is justified in light of the past Government subsidies. First, without the initial Government intervention, the Montreal Extension would not exist today. Second, the book value of the Montreal Extension would be higher today absent the accelerated depreciation. IPAC argued that its proposal would unwind both aspects of the previous subsidies, while the CPA and APMC proposal only recognizes the second component.

Both IPAC and CPA emphasized that producers are more than willing to compete in the market but, in their view, revaluation is necessary to level the playing field.

As noted earlier, Suncor argued that it is premature to render a decision on toll design for a reversed Extension. However, Suncor did state that, to meet the objectives of fairness and efficiency, the accelerated depreciation paid by the Federal Government should, at a minimum, be added back into the rate base if the Montreal Extension is reversed.

SaskOil argued that the Board should rely on the market to determine a value for the Montreal Extension, rather than trying to estimate its value. SaskOil urged the Board to recommend that the Federal Government exercise its option to purchase the Montreal Extension, and then resell it to the highest bidder. Then, SaskOil argued, the rate base of the Montreal Extension could be revalued according to its true market value as represented by the resale price.

IPL opposed revaluing the rate base of the Montreal Extension and argued that the current book value should continue to be used as the rate base. If the rate base of the Montreal Extension were to be increased, additional revenues would be generated compared to IPL's revenue requirement if revaluing did not take place. IPL argued that these additional revenues are evidence that the revenue requirements for a revalued rate base would not be cost-based. IPL also argued that there is essentially no regulatory precedent for increasing the value of the rate base.

The Prospective Shippers agreed with IPL that the rate base of the Montreal Extension should not be upwardly revalued. Although the Federal Government entered into the Deficiency Agreement in order to meet the policy objective of security of oil supply for Quebec and eastern Canada, the Prospective Shippers noted that the Deficiency Agreement also contemplated the reversal of the Montreal Extension. The Prospective Shippers argued that there is no evidence that establishing a secure and economic supply of crude oil for Ontario through the reversed Montreal Extension would be inconsistent with the Government policy objectives which originally necessitated the Montreal Extension. In any event, the Prospective Shippers noted that the Federal Government could still choose to achieve its policy objectives by exercising its option to purchase the Montreal Extension as provided for by the Deficiency Agreement.

Union Gas Limited and the Ministry of Energy for Ontario ("Ontario") also opposed revaluation of the rate base. Ontario argued that if the Montreal Extension were



revalued, Ontario refiners would effectively be subject to a tax which other refiners in Canada do not have to pay, and they would be placed at a competitive disadvantage relative to other refiners who have access to offshore crude oil.

As several parties noted, the Montreal Extension has had a unique history and, in proposing a revaluation of the rate base, some parties have requested that the Board adopt a unique tolling methodology for the Montreal Extension. In assessing the proposals for revaluing the rate base of the reversed Montreal Extension, the Board considered how the principles of cost-based/user-pay tolls and no unjust discrimination would best be achieved, and the Board examined the arguments relating to fairness.

The Board is of the view that the principle of no unjust discrimination for all shippers on a reversed Montreal Extension will be respected, provided all shippers on the reversed Montreal Extension are subject to the same toll charges. Therefore, the principle of no unjust discrimination would not be affected by a revaluation of the rate base.

The next question to be addressed is whether revaluing the rate base would result in tolls which reflect the principle that tolls should be cost-based/user-pay. Each party maintained that its particular proposal for valuing the rate base, whether it involved revaluing the rate base or not, would result in cost-based tolls.

The Board is of the view that, if IPL maintains ownership of the Montreal Extension, any form of revaluation of the rate base would result in tolls which are not consistent with the traditional concept of cost-based tolls. The historical costs associated with the Montreal Extension, including the current level of accumulated depreciation, have been recovered partly through tolls on IPL's systems, and partly through the Federal Government's deficiency payments to IPL. In other words, although the historical costs of the Montreal Extension have not been recovered entirely through tolls, IPL has in fact recovered the costs. Given that these costs have been paid, the Board does not believe that it would be consistent with the principle of cost-based/user-pay tolls to add a portion of these costs back into the rate base.

Several parties emphasized that fairness is a significant part of their justification for revaluing the rate base. Parties representing western Canadian producers argued that fairness will only be achieved by revaluing the rate base in order to avoid giving an unfair competitive advantage to offshore crude oil compared to Canadian crude oil. On the other hand, Ontario argued that revaluation of the rate base would be unjust because Ontario refiners would be required to reimburse the Federal Government for the moneys it spent to "purchase" security of supply for Quebec and eastern Canada.

The Board recognizes that, from the point of view of western Canadian oil producers, it would seem unfair to reverse the Montreal Extension without revaluation of the rate base if the consequence were to reduce prices received by these producers for the sale of their light crude oil. However, the Board notes that it is not clear at this time that the Montreal Extension will be reversed or, if it is, what the timing of the

reversal will be. It may be that, with declining production of light crude from western Canada, the displacement effects will be less than currently anticipated by western Canadian oil producers.

In the Board's view, there was a lack of evidence on the relative costs and benefits of revaluation or no revaluation and therefore, it is difficult to make an objective assessment of fairness. Based on the evidence submitted, the Board is not persuaded that greater fairness would be achieved by revaluing the rate base of a reversed Montreal Extension. However, if an application for reversal facilities for the Montreal Extension were submitted to the Board pursuant to Part III of the Act, the question of fairness will be considered again at that time, particularly in the context of the need for and the timing of the reversal.

The Board concludes that, if IPL maintains ownership of the reversed Montreal Extension, it would be a departure from cost-based tolls to revalue the rate base. The Federal Government has borne part of the historical costs associated with the Montreal Extension in order to achieve the policy objective of security of supply for Quebec and eastern Canada. Any revaluation of the rate base at this time to account for past subsidies would, in the Board's view, have to be considered arbitrary. In addition, the Board was not convinced that greater fairness would be achieved by revaluing the rate base.

However, as several parties noted, the Federal Government may decide to exercise its option to purchase the Montreal Extension. If the Federal Government purchases the Montreal Extension and resells it at a price other than the net book value at the time of sale, the issue of rate base revaluation may be reconsidered at a future toll hearing. The Board is of the view that because the purchase price would be a very real cost associated with the Montreal Extension, the principle of cost-based/user-pay tolls suggests that the purchase price of the asset should be a consideration to which the Board would have regard in determining the appropriate value of the rate base for tollmaking purposes. In addition, the Board notes that the resale price of the Montreal Extension could be argued as representing the fair market value of the facilities. The Board believes that having regard to the market value of the Montreal Extension, as demonstrated by the sale price, could lead to a fair valuation of the rate base. In any event, any party who purchases the Montreal Extension facilities would be required to satisfy the Board that the purchase cost was prudently incurred before the Board would consider including the purchase cost in the rate base. In addition, the Board would consider whether the principle of no double recovery, that is, ensuring that ratepayers do not pay twice for the same asset, is relevant to the situation.

## **Decision**

**If IPL maintains ownership of the Montreal Extension, the rate base will continue to be calculated on the basis of the current net book value of the Extension.**

**If the Montreal Extension is purchased by the Federal Government and resold to a private party, the resale price is a consideration to which the Board would have regard in establishing an appropriate rate base.**

## **10.4 Re-reversal Facilities**

IPL has not yet filed an application for construction of facilities in relation to the potential reversal of the Montreal Extension. However, in this Class 3 application, IPL did provide details of its preferred design. This design incorporated facilities to allow for re-reversal of the Montreal Extension. The approximate cost of the re-reversal facilities was forecast to be \$2.7 million.

IPL justified inclusion of the costs associated with re-reversal facilities on the basis of "security of supply" considerations. IPL also noted that it would be prudent to make the investment in re-reversal facilities at the time of reversal in order that a timely response may be made to any future events that may require re-reversal.

CPA, IPAC, APMC, SaskOil and the Prospective Shippers were all in agreement that re-reversal facilities should not be allowed. They felt that no users were requesting these facilities and, if these costs were incurred on the grounds of "security of supply" considerations, the shippers should not be required to pay for these costs.

Quebec, on the other hand, argued that these costs should be incurred on the grounds of "security of supply" considerations.

## **Views of the Board**

The Board believes that the decisions on whether or not to approve re-reversal facilities and how these costs will be treated for rate base and tolling purposes should be made at the time of a facilities hearing.

## **Decision**

**The decision on the treatment of re-reversal facilities for rate base and tolling purposes is deferred.**



## **10.5 Optimization Study for Changes to Pipeline Configuration**

IPL, as part of its preferred design for the reversal of the Montreal Extension, proposed to convert the portion of the Montreal Extension from Sarnia to Westover to Older System service. The Prospective Shippers argued that it is premature to attempt to deal with optimization of IPL's system at this time. They recommended that a study be carried out by IPL, incorporating the best available forecasts of throughput volumes to optimize its operations.

IPL justified the changes to the configuration of the two systems on the basis of reduced operating and maintenance costs to Older System shippers. In argument, IPL stated that the Prospective Shippers' concerns are unwarranted, and that an optimization study is not necessary.

The Board agrees with the Prospective Shippers that the merits of optimization through changes in pipeline configuration of the Older System and the Montreal Extension should be considered.

### **Decision**

**IPL is directed to prepare an Optimization Study prior to changing the configuration of the Montreal Extension and the Older System . IPL is further directed to include this study as part of any application regarding proposed changes to the configuration of the Older System and the Montreal Extension.**

## Chapter 11

# Tariff Revisions

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IPL filed tariffs which embodied minor changes to reflect IPL's current operating environment. No intervenors questioned these changes.

### **Decision**

**The Board approves these tariff changes.**

## Chapter 12

# Class 2 Toll Adjustments

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### 12.1 Trigger Mechanism

Currently, IPL is required to file an application for new tolls when their rate of return on common equity for the calendar year will exceed that approved by the Board at the most recent toll hearing by more than 2 percentage points.

The question of the continued appropriateness of the 2 percent trigger mechanism for IPL was discussed on pages 9-12 of the Board's December 1990 Reasons for Decision, with respect to a review of toll adjustment procedures ("TO-7-90") and was to be brought forward as an issue for review during the next Class 3 Toll application.

IPL submitted that there is no need for a change to the trigger mechanism nor the imposition of a lower limit. IPL considers the 2 percent limit currently in place has been fair to all parties since it was first utilized in 1980.

IPL was quite concerned with IPAC's suggestion that a full cost of service procedure should be imposed on IPL and that this would be followed by price cap regulation. In IPL's view, following IPAC's suggestion would imply a global deferral account (IPL has a long-standing objection to deferral accounts). IPL submitted that there is no need for a full cost of service rate-making procedure with deferral account procedures.

IPAC stated that, while the 2 percent trigger might be considered a zone of reasonableness, it was not intended to be a band of unaccountability within which IPL has a free rein to do as it pleases. IPAC contended that the 2 percent trigger was not designed to relieve IPL from scrutiny and accountability for variances just because the final cost would be below the cap.

IPAC requested that the Board confirm the purpose of the trigger mechanism and also confirm that it is not meant to act as a barrier to Board action should costs exceed approved levels but still fall below the trigger level. If the Board truly intends that there is no accountability for IPL as long as the trigger is not exceeded, then IPAC requested an immediate review and revamping of the complete trigger mechanism and toll adjustment procedures.

### Views of the Board

In response to IPAC, the Board would clarify that the purpose of the 2 percent trigger mechanism is to establish a guideline as to the timing for Class 3 Toll applications in order to avoid too frequent changes in tolls. It is not the Board's intention that the trigger mechanism should act to prevent or restrict interested



parties from questioning a variance in any area of IPL's operations, if that area is of concern, even if IPL falls within the 2 percent zone. In this context, the Board notes that the trigger mechanism does not have a lower limit but IPL has traditionally not applied for a Class 3 Toll application where the amount of its variance is under the approved return on common equity by less than 2 percent. It is the Board's view that all parties, both IPL and the intervenors, should take the above comments into consideration, when reviewing variances from approved levels and projections for a new test year as to the need for a Class 3 Toll application.

### **Decision**

**The Board is of the view that the 2 percent trigger mechanism currently in place for IPL continues to be appropriate, as a guideline, in determining when a Class 3 Toll application should be filed.**

## **12.2 Adjusting Rate of Return on Rate Base**

The appropriateness of adjusting rate of return on rate base in the context of a Class 2 Toll application was commented on at pages 13-17 of the TO-7-90. In that decision, the Board indicated the issue would be revisited in IPL's next Class 3 Toll application and was made an issue in the current review.

It was IPL's view that all issues related to the capital structure and the rate of return on rate base should be examined simultaneously in a Class 3 Toll application and no components should be examined independently in Class 2 Toll applications. IPL considered that examining some of the components individually would add to the complexity of the application, detract from the appropriate timeframe of a Class 2 Toll application and reduce the value of such applications.

IPL also noted that Trans Mountain Pipe Line Company Limited ("TMPL") in its September 1991 Class 3 Toll application concurred with this position.

IPL considered APMC's suggestion that the embedded cost of debt could be adjusted in the context of a Class 2 Toll application as being ill-advised and impractical. IPL contended that such a change would affect other areas such as the unfunded debt cost rate which, in turn, is related to and affected by the current equity cost rate

APMC disagreed with IPL that issues related to rate of return on rate base should not be treated individually and suggested, that since the pure cost of debt actually held by IPL was not explicitly addressed by the rate of return witnesses, it was difficult to see how the adjustment of debt costs is dependent upon the process of adjusting return on common equity or capital structure.

APMC further suggested that IPL's flexibility in issuing debt allows it to finance when debt costs are low and maintain that level for long periods if the timing of Class 3 Toll applications is infrequent.

APMC concluded that the toll adjustment procedure should be modified to allow revisions to the approved embedded cost of debt within the context of a Class 2 Toll application. It was APMC's view that the increased timeframe allowed for reviewing Class 2 Toll applications (approved in TO-7-90) was sufficient to allow the inclusion of this modification.

No other party put forward any specific views on this issue.

## **Views of the Board**

The Board is of the view that the examination of all elements of cost of capital and capital structure should be done simultaneously. While it is true, as APMC has indicated, that the expert rate of return witnesses did not necessarily comment on embedded cost of debt, it would be difficult to envisage that the current and potential level of long-term debt and its related costs did not enter into the evaluation of the overall financial risks of IPL.

The Board agrees with IPL that the level of long-term financing could have an effect on the level of unfunded debt and considerations regarding common equity cost rates. The Board also placed little emphasis on the argument by APMC regarding the interval between Class 3 Toll applications as being a reason for this change.

## **Decision**

**The Board denies the request that the toll adjustment procedures be revised to allow revisions to the embedded cost of debt within the context of a Class 2 Toll application.**

## Chapter 13

# Interim Tolls

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On 13 December 1991, the Board approved an average interim toll increase of 9 percent for IPL effective 1 January 1992 pending completion of the Board's review of IPL's Class 3 Toll application for the 1992 test year. Order TOI-2-91 which appears as Appendix V outlines the procedure that IPL is required to follow to account for any differences between interim and final tolls.




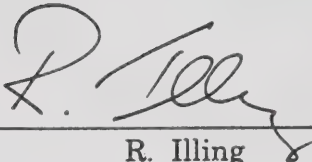
## Chapter 14

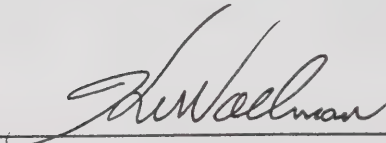
# Disposition

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The foregoing chapters, together with Order TO-1-92, constitute the Board's Reasons for Decision on this application.

  
A.B. Gilmour  
Presiding Member

  
R. Illing  
Member

  
K.W. Vollman  
Member

Calgary, Canada  
June 1992

# Appendix I

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## ORDER TO-1-92

IN THE MATTER OF the *National Energy Board Act* and the regulations made thereunder, and

IN THE MATTER of an application by Interprovincial Pipe Line Inc. (hereinafter called "IPL") dated 27 June 1991, for certain orders respecting tolls and tariffs pursuant to Part IV of the *National Energy Board Act*, filed with the Board under File No. 4200-J001-5.

B E F O R E:

A.B. Gilmour  
Presiding Member

K. Vollman  
Member

R. Illing  
Member

On Thursday the 18th day of June 1992

WHEREAS an application dated 27 June 1991, as revised, has been made to the Board by IPL seeking, inter alia, orders under Part IV of the *National Energy Board Act* fixing the tolls and tariffs IPL may charge for or in respect of the transportation of crude oil and other liquid hydrocarbons effective 1 January 1992.

AND WHEREAS the Board has issued, on 13 December 1991, Order TOI-2-91, stipulating therein tolls to be charged by IPL on an interim basis commencing 1 January 1992.

AND WHEREAS the Board has heard the evidence and submissions of IPL and all interested parties with respect to the application at a public hearing held pursuant to Order RH-2-91 which commenced in Calgary on 2 December 1991;

AND WHEREAS the Board's decisions on the application are set out in its Reasons for Decision dated June 1992 and in this Order;

IT IS ORDERED THAT:

1. IPL shall, for toll-making, tariff and accounting purposes, implement the decisions of the Board outlined in the RH-2-91 Reasons for Decision dated June 1992 ("Reasons for Decision") and this Order.
2. IPL shall calculate the value of each component of the revenue requirement that is identified in the Reasons for Decision as requiring determination by IPL.
3. IPL is directed to, as soon as possible, file with the Board, 25 copies and serve on interested parties to the hearing, 1 copy, of the following:
  - (a) the resulting calculations, all intermediate calculations and working papers used to determine the components of the revenue requirement outlined in paragraph 2;
  - (b) a schedule of tolls conforming with the decisions outlined in the Reasons for Decision and this Order; and,
  - (c) a schedule of tolls and supporting calculations conforming with the decisions outlined in the Reasons for Decision, but which exclude the disposition of any shortfall or excess in revenues in respect of interim tolls.
4. For final tolls to be effective 1 September 1992, the Board requires that the material detailed in paragraph 3 be filed with the Board no later than 14 August 1992.
5. Subsequent to IPL being advised that the tolls filed pursuant to paragraph 3 are acceptable to the Board, IPL will be required to file with the Board and serve on interested parties a printed tariff containing the tolls and reflecting the decisions outlined in the Reasons for Decision.
6. IPL provide a reconciliation for each of the tables listed below showing the nature of the adjustment and the line item affected, the source of the adjustment (amendments by IPL to its Application during the course of the review or adjustments pursuant to Board decisions) and supporting schedules showing any necessary calculations needed to verify a figure that is not self-explanatory.
  - 2-1 Revenue Requirement
  - 2-2 Cost of Service Summary
  - 3-1 Summary of Rate Base - Older System
  - 3-2 Summary of Rate Base - Montreal Extension
  - 3-3 Determination of Working Capital - Older System



- 3-4 Determination of Working Capital - Montreal Extension
- 6-2 Approved Deemed Average Capital Structure and Rates of Return for the Test Year - Older System
- 6-4 Approved Average Capital Structure and Rates of Return for the Test Year - Montreal Extension
- 7-1 Provision for Income Taxes and Deferred Taxes
- 9-1 Operating Expenses

NATIONAL ENERGY BOARD

A handwritten signature in black ink, appearing to read 'SR', is positioned above the printed name and title.

Scott Richardson  
Secretary

# Appendix II

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File No.: 4200-J001-5

Date: 9 September 1991

Hearing Order RH-2-91  
Directions on Procedures

Interprovincial Pipe Line Inc.  
Application for Tolls Effective 1 January 1992

By application dated 27 June 1991, Interprovincial Pipe Line Inc. ("IPL") has applied to the National Energy Board ("the Board") for certain orders respecting tolls under Part IV of the *National Energy Board Act*. The Board has decided to hold a public hearing to consider the application and directs as follows:

## PUBLIC VIEWING

1. IPL shall deposit and keep on file, for public inspection during normal business hours, a copy of its application, amendments, evidence and all documents related thereto in its offices at:

IPL Tower  
10201 Jasper Avenue  
Edmonton, Alberta.  
T5J 2J9

A copy of this application is also available for viewing at the Board's offices in the following locations:

Library  
Room 962  
473 Albert Street  
Ottawa Ontario  
K1A 0E5  
(until 30 September 1991)

and

311-6th Avenue S.W.  
Calgary, Alberta  
T2P 3H2

### INTERVENTIONS

2. Interventions are to be filed with the Secretary and served on IPL by Monday, 23 September 1991. Interventions shall include all the information set out in subsection 32(1) of Part III to the revised draft *NEB Rules of Practice and Procedure* ("the Rules") dated 21 April 1987.
3. The Secretary will issue a List of Intervenor shortly after 23 September 1991.

### SERVICE TO PARTIES

4. IPL shall serve a copy of these Directions on Procedures, including the appendices, in either official language as appropriate or as requested, forthwith on all parties referred to in paragraph 8 of Board Order TO-7-90. IPL is requested to file with the Board a list of all parties served.
5. Once the List of Intervenor is issued by the Board, IPL shall serve its application, amendments, evidence and all documents related thereto on those intervenors who have not already received a copy.
6. Intervenor are reminded that pursuant to section 32 of the Rules, each intervenor must serve a copy of its intervention on the applicant and all other intervenors once the List of Intervenor has been issued by the Board.

### INFORMATION REQUESTS TO IPL

7. Information requests addressed to IPL on the application and on the evidence shall be filed with the Secretary and served on all intervenors to the proceeding by Friday, 11 October 1991.
8. Responses to information requests made pursuant to paragraph 7 shall be filed with the Secretary and served on all intervenors to the proceeding by Monday, 21 October 1991.

### LETTERS OF COMMENT

9. Letters of comment by persons who do not wish to intervene are to be filed with the Secretary and served on IPL by Tuesday, 29 October 1991.



## LIST OF ISSUES

10. The Board intends to examine the issues specified in Appendix II. Any party wishing to suggest an amendment or addition to the List of Issues is requested to do so when it files its intervention. When proposing additional issues, parties should explain the relevance to the hearing and the justification for inclusion of the proposed issue.

Shortly after the receipt of those issues the Secretary will, if necessary, issue an amendment to Appendix II of Order RH- 2-91.

## INTERVENOR WRITTEN EVIDENCE

11. Intervenor written evidence on all issues is to be filed with the Secretary and served on all intervenors to the proceeding by Tuesday, 29 October 1991.

## INFORMATION REQUESTS TO INTERVENORS

12. Information requests addressed to the intervenors who have filed written evidence pursuant to paragraph 11 shall be filed with the Secretary and served on IPL and all other intervenors Monday, 4 November 1991.
13. Responses to the information requests sent pursuant to paragraph 12 shall be filed with the Secretary and served on IPL and all other intervenors by Tuesday 12 November 1991.

## HEARING

14. The hearing will commence in a location (or locations) and at a date(s) and time(s) to be determined later but in no event will it be prior to 18 November 1991.

## NOTICE OF HEARING

15. The publications in which IPL is required to publish the Notice of Public Hearing, attached as Appendix I, are listed in Appendix IV.

## PROCEDURE FOR HEARING OF EVIDENCE AND FINAL ARGUMENTS

16. The evidence of all parties related to the issues of throughput, rate base, cost of service and toll design, and tariff matters will be heard first, followed by the evidence of all parties on rate of return matters.

With respect to the hearing of evidence, the following procedure shall apply:

- (a) IPL shall present its evidence;

- (b) intervenors and Board Counsel shall have the right to cross-examine IPL's witnesses;
  - (c) intervenors shall present their evidence in an order to be specified at the commencement of the proceedings;
  - (d) after each intervenor has presented its evidence, other intervenors, IPL and Board Counsel shall have the right of cross-examination; and
  - (e) IPL may present reply evidence.
17. Following the evidentiary portion of the hearing, final argument shall be heard on all issues discussed at the hearing.

#### FILING AND SERVICE REQUIREMENTS

18. Where parties are directed by these Directions on Procedures or by Rules to file or serve documents on other parties, the following number of copies shall be served or filed:
- (a) for documents to be filed with the Board, provide 35 copies;
  - (b) for documents to be served on IPL, provide 3 copies; and,
  - (c) for documents to be served on intervenors, provide 1 copy.
19. Parties filing or serving documents at the hearing shall file five copies with the Hearing Clerk, ten copies with the Board counsel, serve three copies on the applicant and provide sufficient copies for all other parties present at the hearing.
20. Persons filing letters of comment shall serve one copy on IPL and file one copy with the Board, which in turn will provide copies for all other parties.
21. Parties filing or serving documents fewer than five days prior to the commencement of the hearing shall also bring to the hearing a sufficient number of copies of the document for use by the Board and other parties present at the hearing.
22. Parties are reminded that pursuant to subsections 8(4) and 9(1) of the Rules, a document is not filed or served until it is received by the intended recipient

#### TIMETABLE OF EVENTS

23. A summary of deadlines for filing and service is listed in Appendix III.

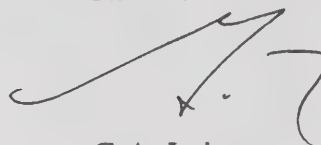
#### SIMULTANEOUS INTERPRETATION

24. Each party is requested to indicate in its intervention the official language it intends to use at the hearing. If it appears that both languages will be used, simultaneous translation will be provided.

GENERAL

25. Unless otherwise directed by the Board, the hours of sitting will be from 8:30 a.m. to 1:00 p.m.
26. All parties are asked to quote Hearing Order RH-2-91 and File No. 4200-J001-5 when corresponding with the Board in this matter.
27. Subject to the foregoing, the procedure to be followed shall be governed by the draft *NEB Rules of Practice and Procedure*.
28. The National Energy Board is operational in Calgary at the following address:  
  
Cadillac Fairview Building  
311-6th Avenue, S.W.  
Calgary, Alberta  
T2P 3H2 .
29. For further information on the application described herein, or the procedures governing the Board's review, contact the Regulatory Support Office at (403) 292-4800 in Calgary.

NATIONAL ENERGY BOARD

A handwritten signature in black ink, appearing to read 'G.A. Laing', with a stylized flourish at the end.

G.A. Laing  
Secretary



NATIONAL ENERGY BOARD  
NOTICE OF PUBLIC HEARING

INTERPROVINCIAL PIPE LINE INC.  
APPLICATION FOR TOLLS EFFECTIVE 1 JANUARY 1992

The National Energy Board ("the Board") will conduct a hearing on an application dated 27 June 1991 by Interprovincial Pipe Line Inc. ("IPL") pursuant to Part IV of the *National Energy Board Act* for certain orders respecting tolls that IPL may charge for services rendered for the period 1 January to 31 December 1992.

The hearing will commence at a time and date in a location to be announced later.

The hearing will be public and will be held to obtain the evidence and the relevant views of the interested parties on the application.

Anyone wishing to intervene in the hearing must file a written intervention with the Secretary of the Board and serve three copies on IPL at the following address:

**Mr. D.B. MacDermott**  
**Vice President, Law and Corporate Secretary**  
**Interprovincial Pipe Line Inc.**  
**IPL Tower**  
**10201 Jasper Avenue**  
**P.O. Box 398**  
**Edmonton, Alberta**  
**T5J 2J9**

**Telephone: (403)420-5210**  
**Facsimile: (403)420-5166**

IPL will provide a copy of the application to each intervenor.

The deadline for receipt of written interventions is Monday, 23 September 1991. The Secretary will then issue a List of Intervenors.

Anyone who does not wish to intervene in the hearing but would like only to comment on the application should write to the Secretary of the Board and send a copy to IPL. The deadline for receipt of comments is Tuesday, 29 October 1991.

Information on the procedures of this hearing (Hearing Order RH-2-91) or the draft *NEB Rules of Practice and Procedures* governing all hearings (both documents are available in English and French) may be obtained by writing the Secretary or telephoning the Board's Regulatory Support Office at (403) 292-4800 in Calgary.

G.A. Laing  
Secretary  
National Energy Board  
311 - 6th Avenue S.W.  
Calgary, Alberta  
T2P 3H2

Facsimile: (403) 292-5503

LIST OF ISSUES

In addition to the usual rate base, cost of service, throughput and rate of return issues, the Board intends to examine during the hearing, but does not limit itself to, the following issues:

1. The effect of the recent corporate reorganization on:
  - allocation methodologies of costs between regulated and non-regulated activities
  - appropriate capital structure.
2. A review of the appropriate treatment of costs related to the Sarnia to Montreal Pipeline and the appropriate toll design treatment given the current status of the Montreal Extension.
3. The appropriateness of the current level of surcharges on heavy petroleums, medium petroleums, light petroleums, gasolines and condensates and Natural Gas Liquids and the basis upon which they are calculated.
4. The appropriateness of IPL's person year requirements.
5. The appropriate disposition of the deferral account established with respect to TransAlta Utilities Corp.
6. The methodology used to calculate IPL's oil degradation loss.
7. The appropriate production margins to be used in establishing producibility estimates.
8. The appropriate disposition of preliminary investigation costs related to the NGL storage facilities considered pursuant to RH-3-90 and GHW-3-90.
9. The appropriateness of adjusting rate of return on rate base in the context of Class 2 toll applications.



TIMETABLE

IPL application filed	27 June 1991
IPL written evidence filed	6 September 1991
Interventions to be filed	23 September 1991
Information requests to IPL due	11 October 1991
Responses by IPL due	21 October 1991
Intervenors written evidence due	29 October 1991
Letters of comment due	29 October 1991
Information requests to intervenors due	4 November 1991
Responses by intervenors due	12 November 1991
Hearing to begin in a location to be determined	To be determined
Hearing to adjourn for Christmas	20 December 1991
Hearing to reconvene if necessary	To be determined

LIST OF PUBLICATIONS

Notice to be Published in English

<u>Publication</u>	<u>City</u>
"Herald"	Calgary, Alberta
"The Edmonton Journal"	Edmonton, Alberta
"Leader Post"	Regina, Saskatchewan
"Winnipeg Free Press"	Winnipeg, Manitoba
"The Gazette"	Montreal, Quebec
"Quebec Chronicle Telegraph"	Quebec, Quebec
"The Globe and Mail"	Toronto, Ontario
"Star",	
"The Financial Post", and	
"Financial Times of Canada"	
"The Ottawa Citizen"	Ottawa, Ontario

Notice to be Published in French

<u>Publication</u>	<u>City</u>
"Le Franco-Albertain"	Edmonton, Alberta
"Journal L'Eau Vive"	Regina, Saskatchewan
"La Liberté"	St. Boniface, Manitoba
"Le Devoir" and "La Presse"	Montreal, Quebec
"Le Soleil"	Quebec, Quebec
"L'Express"	Toronto, Ontario
"Le Droit"	Ottawa, Ontario

Notice to be Published in Both English and French

<u>Publication</u>	<u>City</u>
The "Canada Gazette"	Ottawa, Ontario

## Appendix III

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File No.: 4200-J001-5

Date: 10 October 1991

ORDER AO-1-RH-2-91  
(Amending Hearing Order RH-2-91)

Amendment to Directions on Procedures

Interprovincial Pipe Line Inc.  
Application for Tolls Effective  
1 January 1992

WHEREAS on 9 September 1991 the Board issued Hearing Order RH-2-91 which established the filing requirements and other procedural directions for the RH-2-91 Hearing;

AND WHEREAS the Board has decided to amend Hearing Order RH-2-91 to establish the dates and locations of the Hearing, revise the initial List of Issues (Appendix II to Hearing Order RH-2-91) and issue a list of those parties who have filed notices of interventions.

THEREFORE IT IS ORDERED THAT Hearing Order RH-2-91 be amended by deleting existing paragraphs 7, 8, 9, 11, 12, 13, 14, 23 and replacing them with the following:

7. Information requests addressed to IPL on its application and on the evidence shall be filed with the Secretary and served on all intervenors to the proceeding by Tuesday, 15 October 1991.
8. Responses to information requests made pursuant to paragraph 7 shall be filed with the Secretary and served on all intervenors to the proceeding by Wednesday, 1 November 1991.
9. Letters of comment by persons who do not wish to intervene are to be filed with the Secretary and served on IPL by Tuesday, 12 November 1991.
11. Intervenor written evidence on all issues is to be filed with the Secretary and served on all intervenors to the proceeding by Tuesday, 12 November 1991.
12. Information requests addressed to the intervenors who have filed written evidence pursuant to paragraph 11 shall be filed with the Secretary and served on IPL and all other intervenors to the proceedings by Wednesday, 20 November 1991.



13. Responses to the information requests sent pursuant to paragraph 12 shall be filed with the Secretary and served on IPL and all other intervenors by Friday, 29 November 1991.

14. The hearing process will be as follows:

The Hearing will commence at 1:00 p.m. on Monday, 2 December 1991 in the Hearing Room (room 301) of the National Energy Board at 311 - 6th Avenue S.W. Calgary, Alberta. All issues with the exception of Items 2(a) and 2(b) as listed in the List of Issues appended to Order AO-1-RH-2-91 will be examined. This portion of the Hearing will adjourn on Friday, 20 December 1991.

The Hearing will reconvene on Tuesday, 14 January 1992 at 8:30 a.m. in Toronto, Ontario at a location to be announced at a later date. Issues 2(a) and 2(b) as listed in the List of Issues appended to Order AO-1-RH-2-91 will be examined at this time. This portion of the Hearing will adjourn on Friday, 24 January 1992.

The Hearing will reconvene on Monday, 10 February 1992 at 1:00 p.m. in the Hearing Room (Room 301) of the National Energy Board in Calgary. At this portion of the Hearing any issues not already considered will be examined and final argument will take place.

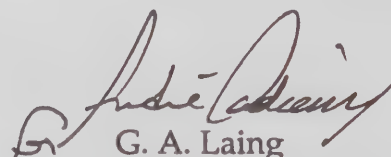
23. A summary of the revised deadlines for filing and service is listed in Appendix III to Order AO-1-RH-2-91.

IT IS FURTHER ORDERED THAT Hearing Order RH-2-91 is amended by adding the following:

30. IPL shall serve a copy of this Amendment to the Directions on Procedures, including the appendices, in either official language, as appropriate or as requested, forthwith on all parties referred to in paragraph 8 of Board Order TO-7-90 and on any other person who has identified himself as an interested person.

IT IS FURTHER ORDERED THAT Hearing Order RH-2-91 is amended by replacing the List of Issues attached to the Hearing Order as Appendix II with the List of Issues attached as Appendix II to this Amending Order.

NATIONAL ENERGY BOARD

  
G. A. Laing  
Secretary

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## LIST OF ISSUES

In addition to the usual rate base, cost of service, throughput and rate of return issues, the Board intends to examine, but does not limit itself to, the following issues:

1. The effect of the recent corporate reorganization on:
  - methodologies for the allocation of costs between regulated and non-regulated activities
  - appropriate capital structure
2. (a) A review of the appropriate treatment of costs related to the Sarnia to Montreal Pipeline and the appropriate toll design treatment given the current status of the Montreal Extension,  
  
(b) An examination of the appropriate treatment of the estimated costs related to and the appropriate toll design methodology for the scenario where the Montreal Extension would be reversed to allow east to west movements of crude oil. The Board will not consider the scenario where the line would be converted to the transmission of natural gas.
3. The appropriateness of the current level of surcharges on heavy petroleums, medium petroleums, light petroleums, gasolines and condensates and natural gas liquids and the basis upon which these surcharges are calculated.
4. The appropriateness of IPL's estimated person year requirements.
5. The appropriate disposition of the deferral account established with respect to TransAlta Utilities Corp.
6. The methodology used to calculate IPL's oil degradation loss.
7. The appropriate production margins to be used in making estimates of producibility.
8. The appropriate disposition of the preliminary investigation costs related to NGL storage facilities considered pursuant to RH-3-90 and GHW-3-90.
9. The appropriateness of adjusting rate of return on rate base in the context of Class 2 toll applications.

The Board also intends to examine the following issue identified by intervenors:

10. The appropriateness of requiring IPL to file an updated depreciation study.

TIMETABLE

IPL application filed	27 June 1991
IPL written evidence to be filed	6 September 1991
Interventions to be filed	23 September 1991
Information requests to IPL due	15 October 1991
Responses by IPL due	1 November 1991
Letters of comment due	12 November 1991
Intervenors written evidence due	12 November 1991
Information requests to intervenors due	20 November 1991
Responses by intervenors due	29 November 1991
Hearing to begin (in Calgary)	2 December 1991
Hearing to adjourn	20 December 1991
Hearing to reconvene (in Toronto)	14 January 1992
Hearing to adjourn	31 January 1992
Hearing to reconvene (in Calgary)	10 February 1992



## Appendix IV

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File No.: 4200-J001-5

Date: 5 November 1991

ORDER AO-2-RH-2-91  
(Amending Hearing Order RH-2-91, as amended)

Amendment to Directions on Procedures

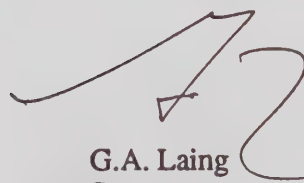
Interprovincial Pipe Line Inc.  
Application for Tolls Effective  
1 January 1992

WHEREAS on 9 September 1991 the Board issued Hearing Order RH-2-91, as amended, which established the filing requirements and other procedural directions for the RH-2-91 Hearing;

AND WHEREAS the Board has decided to further amend Hearing Order RH-2-91 to revise the List of Issues (Appendix II to Hearing Order RH-2-91, as amended).

THEREFORE IT IS ORDERED THAT Hearing Order RH-2-91, as amended, be further amended by replacing the List of Issues (Appendix II) with the revised List of Issues attached.

NATIONAL ENERGY BOARD



G.A. Laing  
Secretary

### REVISED LIST OF ISSUES

In addition to the usual rate base, cost of service, throughput and rate of return issues, the Board intends to examine, but does not limit itself to, the following issues:

1. The effect of the recent corporate reorganization on:
  - methodologies for the allocation of costs between regulated and non-regulated activities
  - appropriate capital structure
2. (a) A review of the appropriate treatment of costs related to the Sarnia to Montreal Pipeline and the appropriate toll design treatment given the current status of the Montreal Extension,  
  
(b) An examination of the appropriate treatment of the estimated costs related to and the appropriate toll design methodology for the scenario where the Montreal Extension would be reversed to allow east to west movements of crude oil. The Board will not consider the scenario where the line would be converted to the transmission of natural gas.
3. The appropriateness of the current level of surcharges on heavy petroleum, medium petroleum, light petroleum, gasolines and condensates and natural gas liquids and the basis upon which these surcharges are calculated.
4. The appropriateness of IPL's estimated person year requirements.
5. The appropriate disposition of the deferral account established with respect to TransAlta Utilities Corp.
6. The methodology used to calculate IPL's oil degradation loss.
7. The appropriate production margins to be used in making estimates of producibility.
8. The appropriate disposition of the preliminary investigation costs related to NGL storage facilities considered pursuant to RH-3-90 and GHW-3-90.
9. The appropriateness of adjusting rate of return on rate base in the context of Class 2 toll applications.

The Board also intends to examine the following issues identified by intervenors:

10. The appropriateness of requiring IPL to file an updated depreciation study.
11. The matter of whether IPL's provision for income taxes should continue to be made under the normalized method.

# Appendix V

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## ORDER TOI-2-91

IN THE MATTER OF the *National Energy Board Act*  
("the Act") and the regulations made thereunder; and

IN THE MATTER OF the tolls to be charged by  
Interprovincial Pipe Line Inc. ("IPL"); filed with the Board  
under File No. 4200-J001-5.

BEFORE the Board on 6 and 10 December 1991.

WHEREAS IPL filed an application dated 27 June 1991 for approval under Part IV of the Act to increase its tolls by an average of 10% effective 1 January 1992:

AND WHEREAS IPL's Application included draft Tariffs which contain a number of changes required by the Applicant's current operating conditions, to ensure consistency between the rules and regulations applying to crude petroleum, natural gas liquids and refined petroleum products, and to reduce ambiguity and improve clarity;

AND WHEREAS on 9 September 1991 the Board issued Hearing Order RH-2-91 which established the hearing to review IPL's application for tolls effective 1 January 1992;

AND WHEREAS IPL in a letter dated 28 November 1991, indicated that based upon updated forecasts, the average toll increase of 10%, as filed in IPL's Application, would increase to 12%;

AND WHEREAS IPL has requested in its 28 November 1991 letter that the average increase in tolls of 12% be approved on an interim basis effective 1 January 1992:

AND WHEREAS IPL has also requested that an adjustment be made for any difference between interim tolls and final tolls for the period of time that such interim tolls are in effect;

AND WHEREAS the Board will not issue a final decision with respect to IPL's final tolls for the year 1992 until after the completion of the RH-2-91 Hearing;

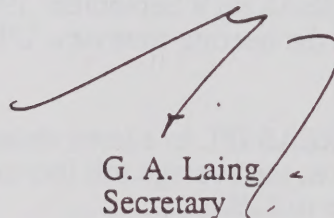


THEREFORE IT IS ORDERED THAT:

Pursuant to subsection 19(2) and sections 59 and 66 of the Act:

1. the Board approves an average interim toll increase of 9% for IPL, effective 1 January 1992, pending the completion of the Board's review of IPL's application. This interim toll increase is to be calculated by multiplying each of the individual proposed toll increases applied for in the Company's Class 3 Toll Adjustment Application for 1992 Tolls, dated 27 June 1991 and adjusted to take into consideration the Company's updated forecasts, by a factor of 0.75;
2. any adjustment that may be required to account for a difference between interim and final tolls, if any, shall be subject to carrying charges and shall be applied on a prospective basis in accordance with procedures established in section 8.7 of the Board's Decision RH-4-86, dated June 1987, entitled "Interprovincial Pipe Line Limited, Application dated 5 September 1986 for new tolls effective 1 January 1987";
3. draft tariffs 165, 166, 167 and 168 as filed in IPL's Class 3 Application, dated 27 June 1991, are hereby suspended, pending the Board's review of IPL's Application; and
4. this interim order will remain in effect until the day before the Board's final order on IPL's Application comes into effect.

NATIONAL ENERGY BOARD



G. A. Laing  
Secretary





